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OCTOBER TERM, 1928

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No. 121

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY AND MANUFACTURERS' RAILWAY COMPANY, APPELLANTS

v.

UNITED STATES OF AMERICA AND INTERSTATE COMMERCE COMMISSION, APPELLEES

---

No. 122

UNITED STATES OF AMERICA AND INTERSTATE COMMERCE COMMISSION, APPELLANTS

v.

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY AND MANUFACTURERS' RAILWAY COMPANY, APPELLEES

---

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI

---

BRIEF FOR APPELLEES INTERSTATE COMMERCE COMMISSION

---

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Appellee and Cross-Appellant.

December 26, 1928.

**Citation to Opinion in Court Below**

ST. LOUIS & O'FALLON RY. CO. ET AL

*v.*

UNITED STATES ET AL

22 F. (2d) 980

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# In the Supreme Court of the United States

OCTOBER TERM, 1928

---

No. 131

ST. LOUIS & O'FALLON RAILWAY CO. ET AL., APPELLANTS

*v.*

UNITED STATES OF AMERICA ET AL., APPELLEES

---

No. 132

UNITED STATES OF AMERICA ET AL., APPELLANTS

*v.*

ST. LOUIS & O'FALLON RAILWAY CO. ET AL., APPELLEES

---

*APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI*

---

## BRIEF FOR THE INTERSTATE COMMERCE COMMISSION

---

### STATEMENT OF CASE

The issue presented in this case is the validity of an order of the Interstate Commerce Commission for the recapture of excess earnings of the St. Louis and O'Fallon Railway Company for the last ten

months of 1920 and for the calendar years 1921, 1922, and 1923 under the provisions of the Transportation Act of 1920. The appellants attack the order (Par. 29, R. 28–30) upon eight distinct grounds. Appellants' brief (pp. 18–22) lists 6 "Grounds of Attack Upon the Order in This Court and in the Court Below." The Index to appellants' brief (I–X) states 13 points in which it is alleged that "The Court below erred in refusing to review the Commission's determination of the value of the property of the O'Fallon." The "Specification of Errors" (appellants' brief, pp. 24–28) specifies 40 alleged errors. The appellants' argument proceeds under the 13 headings, with many subheadings, given in the Index. The 6 "Grounds of Attack Upon the Order" may be fairly summarized as follows: It is alleged that the order is invalid (*a*) because it is based upon an alleged erroneous and inadequate valuation of the property upon which the excess of its earnings over 6 per cent was computed and, in particular, that the valuation is less than the hypothetical cost of reproducing the railroad on the basis of current commodity prices for the periods in question; (*b*) because the O'Fallon Railroad and the Manufacturers' Railway constituted "a group of carriers under common control and management and operated as a single system" within the meaning of the Act, and that if the total earnings of the two railroads were treated as a unit there were no recapturable excess earnings, as the

excess on the O'Fallon would have been reduced by the deficit on the Manufacturers'; (*c*) because the Commission exceeded its power in directing the payment of interest on the sums which it found were payable by the O'Fallon; (*d*) because the establishment of the rates contemplated by the Act is a condition precedent to the exercise of the recapture provisions and that such rates have not been so established; (*e*) because in no event can income arising prior to August 26, 1920 be subject to recapture, as that was the date upon which the rate increases that were authorized by the Commission became effective; and (*f*) because both the statute and the order are invalid as to the provisions requiring one-half of the excess income to be placed in the "Reserve Fund," which it is alleged amounts to taking private property without just compensation and without due process of law.

The answers of the Commission to these claims are concisely set forth in the Summary of our Argument. It is sufficient to state here for the better understanding of the opinion of two of the three judges who composed the trial court that the recapture base or "value" fixed by the Commission was $856,065 for the ten months ending December 31, 1920; $875,360 for the calendar year 1921; $978,884 for the calendar year 1922; and $978,246 for the calendar year 1923; and for these respective periods the net earnings of the railroad, *after recapture*, amounted to $106,755.96, $130,205.13,

$106,391.03, and $110,409.22 or 13.44 per cent, 11.43 per cent, and 11.64 per cent for the three full calendar years, respectively. The value claimed by the railroad in its amended petition in the case at bar is "at least $1,350,000," and on this as a recapture base, the net earnings for the three full annual periods in question, *after recapture*, were 8.71 per cent for 1921, 8.29 per cent for 1922, and 8.44 per cent for 1923.

If the valuations that might have been contended for under the testimony as to index figures for commodity and labor prices current during these same periods in question (Commission's report, p. 31), had been adopted, the net earnings on these valuations, *after recapture*, would have produced 7.52 per cent for 1921, 8.76 per cent for 1922, and 8.10 per cent for 1923.

The petition of appellants was filed in the District Court of the United States for the Eastern Division of the Eastern Judicial District of Missouri, where the special statutory court provided for the trial of such cases unanimously sustained the order of the Commission with a modification allowing interest on each of the recapture amounts only from June 17, 1927, instead of beginning four months after the termination of each period respectively for which the excess income was computed, as the Commission's order required. This court consisted of Circuit Judges Kimbrough Stone and Arva S. Van Valkenburgh, and District Judge

Charles B. Faris. Their decision and opinions will be found in 22 F. (2d) 980.

Judges Stone and Van Valkenburgh held (I) that on the record no issue of "confiscation" was involved, and that it was, therefore, "unnecessary to examine and determine the various contentions made by the parties and *amicii curiae* concerning the proper manner of ascertaining value herein." Judge Faris held that the record did raise the issue of confiscation if the contentions of the plaintiffs (appellants) were correct as to the proper interpretation of the law, but that their contentions were not sound and that the order of the Commission (except as to interest) compiled with the statute and was constitutionally valid and proper—"that it reached the valuation found by it in the only way possible, in a situation so difficult as that absolute certainty and correctness is well nigh finitely impossible."

The decision of the trial court was also unanimous as to the relatively minor objections made to the Commission's order. The court found that the Commission correctly held (II) that The St. Louis and O'Fallon Railway Co. and the Manufacturers' Railway Company were not "operated as a single system" within the meaning of the statute; (III) that recapture of excess earnings was not to be postponed until rates had been fixed by the Commission and had become operative so as to produce the contemplated earnings upon the aggregate value

(previously fixed by the Commission) of the carriers as a whole or in the group in which appellants had been included; (IV) that Section 15a of the Act is not invalid as a delegation of legislative power without prescribing a method of procedure; (V) that the provision of the statute requiring that the remaining one-half of the excess earnings be placed in a reserve fund (as required by paragraph 6 of Section 15a) was also not invalid; (VI) that interest was payable but only from 90 days after the date of the Commission's order, entered February 15, 1927 (and not from four months after the respective recapture periods); and (VII) that the excess earnings for the period between March 1, 1920, and August 26, 1920, were subject to recapture.

THE CROSS APPEAL

No. 132 embraces the cross appeal of the United States and the Interstate Commerce Commission from that part of the Judgment of the three judges in which they decided that interest upon the amounts subject to recapture for each recapture period should be computed from June 17, 1927 (May 17, 1927), instead of from May 1 for each year following the period for which the amounts subject to recapture were determined as provided in the order of the Interstate Commerce Commission of February 15, 1927.

The contention on the cross appeal is that the court erred in its decision regarding this point.

JURISDICTION OF THIS COURT

The direct appeal and the cross appeal to this Court have been taken pursuant to paragraph (4) of Section 238 of the Judicial Code, as amended. The decree of the trial court, consisting of three judges, sought to be reviewed, is dated December 19, 1927, and appears at pages 148 and 149 of the record herein.

The case was brought by the appellants in No. 131, petitioners below, under the provisions of the Urgent Deficiencies Act of October 22, 1913, 38 Stat. L. 208, 219, to enjoin, set aside, annul, or suspend in whole or in part (R. 3–33) an order entered by the Interstate Commerce Commission on February 15, 1927 (R. 37–108). The direct appeal in No. 131 is from that part of the final decree dismissing the appellants' petition on the merits. (R. 153–159.) The cross appeal in No. 132 is from that part of the final decree which directed a modification of the order of the Commission in respect of the time from which interest should be paid by appellant, The St. Louis & O'Fallon Railway Company, upon the amounts payable to the Commission under its order aforesaid. (R. 163–165.)

The position of the appellee in No. 131, cross appellant in No. 132, regarding the jurisdiction of this Court on a direct appeal from the final decree of the District Court, may be summarized as follows:

1. Par. 4 of Sec. 238 of the Judicial Code means that appeals to this Court lie in all cases (*a*) to

*enforce* orders of the Interstate Commerce Commission other than for the payment of money, and (*b*) to *set aside or suspend* all orders of the Interstate Commerce Commission whether for the payment of money or otherwise. This interpretation results necessarily from a consideration of Section 238 of the Judicial Code, the Urgent Deficiencies Act and the Commerce Court Act, in their proper interrelationship.

2. If such interpretation is erroneous, and if Par. 4 of Section 238 of the Judicial Code were interpreted to prevent appeals in cases to set aside or suspend orders of the Interstate Commerce Commission for the payment of money, and if a recapture order were one for the payment of money, it would follow that the Interstate Commerce Commission and the United States would have no right of appeal when a District Court sets aside a recapture order.

3. Recapture orders are not "orders for the payment of money," within the meaning of the statute. The phrases "orders for the payment of money" and "orders other than for the payment of money," as applied to orders of the Interstate Commerce Commission, were first used in the Hepburn Act, now Sec. 16 of the Interstate Commerce Act, where it is made plain that orders for the payment of money are those in which the Commission awards to a claimant damages resulting from a violation of the Act, and are to be "enforced" by the complain-

ant or "any person for whose benefit such order was made," in an action in the nature of a civil suit in which "the findings and order of the Commission shall be prima facie evidence of the facts stated therein." The Commerce Court was never given jurisdiction of such a case, but it was given, and the District Courts now have, jurisdiction of all other cases to enforce or set aside orders of the Interstate Commerce Commission.

4. Briefly, Par. 4 of Section 238 of the Judicial Code provides a right of appeal to this Court in all cases in which the District Courts now have jurisdiction either to enforce or set aside orders of the Interstate Commerce Commission.

The order of the Commission was affirmative in that the Interstate Commerce Commission, pursuant to the provisions of Section 15a of the Interstate Commerce Act, and particularly paragraphs (4), (5), and (6) thereof, determined and set forth therein the value of the railway property and the net railway operating income for 10 months of the year 1920, and for the years 1921, 1922, and 1923; and upon the making of such determinations by the Commission, it became, by virtue of the provisions of paragraph (6) of said Section 15a, and by operation thereof, the duty of the appellant to place in a reserve fund to be established and maintained by such carrier one-half of the amount by which its net railway operating income exceeded six per centum of the value of its railway property for each of

such periods and to pay to the Commission for the purpose of establishing and maintaining a general railroad contingent fund the remaining one-half of such excess income; and the Commission determined the total amount of such excess income for each of such periods and required the appellant to place one-half thereof in a reserve fund and to pay the remaining one-half to the Commission as prescribed in said paragraph. The effect, therefore, of the operation of such statute upon the determinations of the Commission was an affirmative direction to the carrier to place excess earnings in such reserve fund and in the possession of the Commission in the amounts stated in the Commission's order, and within the time therein specified. The following cases, among others, in which this Court has exercised its jurisdiction upon direct appeals from district courts in suits brought to enjoin, set aside, annul, or suspend affirmative orders of the Interstate Commerce Commission, are believed to sustain the jurisdiction of this Court.

*Dayton-Goose Creek Ry. Co.* v. *United States*, 263 U. S. 456.

*Western Chemical Company* v. *United States*, 271 U. S. 268.

*Virginian Ry. Co.* v. *United States*, 272 U. S. 658.

*Assigned Car Cases*, 274 U. S. 564.

Paragraph (4) of Section 238 of the Judicial Code, as amended, authorizes a direct appeal to this Court in all cases in which an appeal is authorized in—

> 4. So much of "an act making appropriations to supply urgent deficiencies * * *", approved October 22, 1913, as relates to the review of interlocutory and final judgments and decrees in suits to enforce, suspend, or set aside orders of the Interstate Commerce Commission other than for the payment of money.

By the Urgent Deficiencies Act the Commerce Court was abolished from and after December 31, 1913, and the jurisdiction then vested in said Commerce Court by an Act entitled "An Act to Create a Commerce Court," etc. (36 Stat. L. 539), was transferred to and vested in the several district courts of the United States. The Urgent Deficiencies Act provides that—

> a final judgment or decree of the district court may be reviewed by the Supreme Court of the United States if appeal to the Supreme Court be taken by an aggrieved party within 60 days after the entry of such final judgment or decree, and such appeals may be taken in like manner as appeals are taken under existing law in equity cases.

Since no distinction is made in that act between suits involving orders of the Interstate Commerce Commission "for the payment of money" and "other than for the payment of money," the distinction now made in paragraph (4) of Section 238 of the Judicial Code must be understood as relating back to the provisions of the Commerce Court Act, wherein it was provided:

> SEC. 1. That a court of the United States is hereby created which shall be known as the Commerce Court and shall have jurisdiction now possessed by circuit courts of the United States and the judges thereof over all cases of the following kinds:
>
> First. All cases for the enforcement, otherwise than by adjudication and collection of a forfeiture or penalty or by infliction of criminal punishment, of any order of the Interstate Commerce Commission *other than for the payment of money.* (Italics ours.)
>
> Second. Cases brought to enjoin, set aside, annul, or suspend in whole or in part any order of the Interstate Commerce Commission.
>
> Third. * * *

It is therefore obvious that the Commerce Court was given jurisdiction for the *enforcement* of certain orders of the Commission *other than for the payment of money,* and that it had no jurisdiction to enforce orders for the payment of money. It is also obvious that the Commerce Court was given jurisdiction over *all cases brought to enjoin, set aside, annul, or suspend* orders of the Commission irrespective of whether these were orders for the payment of money or otherwise. Since by the Urgent Deficiencies Act the jurisdiction of the Commerce Court was transferred to the several district courts of the United States, it follows that the district courts now have original jurisdiction of *all cases for the enforcement* (otherwise than by adjudication and collection of a forfeiture or pen-

alty or by infliction of criminal punishment), of any order of the Interstate Commerce Commission *other than for the payment of money;* and that they have no jurisdiction to *enforce* orders for the payment of money. They have also jurisdiction *to suspend and set aside* in whole or in part "any order of the Interstate Commerce Commission," which means those directing the payment of money, as well as those relating to matters other than for the payment of money.

The obvious construction of paragraph (4) of Section 238 of the Judicial Code, therefore, is that an appeal to this Court does not lie in cases to *enforce* orders of the Commission for the payment of money, and that the right of appeal exists in all cases to enforce orders other than for the payment of money and to *suspend or set aside all orders* of the Commission whether for the payment of money or otherwise.

The construction suggested above implies that under paragraph (4) of Section 238 of the Judicial Code a direct appeal to this Court is authorized in all cases involving orders of the Interstate Commerce Commission of which the district courts have jurisdiction for the purpose either of enforcing or enjoining orders of the Commission. If it is considered, however, that a literal interpretation of the wording of paragraph (4) of Section 238 of the Judicial Code precludes an appeal to this Court in any case in which a district court, although having proper jurisdiction, decides to suspend or set aside

an order of the Commission "for the payment of money," it follows that if orders of the Commission in recapture cases are orders "for the payment of money," they may be set aside by the district courts, and in such case the United States and the Commission would have no right of appeal.

It is clear, however, that orders of the Commission in recapture cases are not orders "for the payment of money." This follows, first, from the nature of such orders. Embracing as they do the reports of the Commission they contain the Commission's determination of value, of net railway operating income, of the excess thereof over six per cent of the ascertained value of the property, and specify the one-half of such excess which by operation of law (paragraph (6) of Section 15a) the carrier is required to place in its reserve fund and the one-half to be turned over to the Commission for the account of the general railroad contingent fund. Such orders may, as does the order in this case, direct the carrier to place one-half of the excess in its reserve fund and pay the remaining one-half to the Commission, but that is no more than the statute requires irrespective of such direction in the Commission's order. The form of the order in this particular does not alter its nature nor add anything to the obligation of the carrier under the statute. The order here involved is, indeed, but an incident in the administration by the Commission of the provisions of Section 15a which require on the one hand that the Commission adjust rates

for the carriers as a whole or in groups so as to enable them, as nearly as may be, to earn a fair return on the aggregate value of their properties, and on the other hand that any individual carrier which receives for any recapture period a net railway operating income in excess of six per cent of the value of its individual property shall dispose of such excess in the manner prescribed in that section. This Court has referred to the recapture clauses as "the key provision of the whole plan." If, therefore, an order in a recapture case directs the carrier to do what the Act itself requires; namely, to place one-half of its excess income in a reserve fund and to turn the other one-half over to the Commission, it is not an order "for the payment of money" but is a regulation essential in the administration of "the whole plan."

Second, the meaning of the phrase "orders • • • other than for the payment of money" as it appears in paragraph (4) of Section 238 of the Judicial Code is to be understood, as heretofore stated, in the sense in which it was used in the Commerce Court Act. That Act was approved June 18, 1910. Its purpose obviously was to provide judicial machinery for the enforcing and restraining of orders made by the Interstate Commerce Commission pursuant to its authority under the Act then known as the Act to Regulate Commerce. At the time of its enactment by Congress, Section 16 of the Act to Regulate Commerce, as amended by the Act of June 29, 1906, 34 Stat. L. 584, was in effect,

and it made a distinction between orders for the payment of money and orders other than for the payment of money. It provided:

> That if, after hearing on a complaint made as provided in Section thirteen of this Act, the Commission shall determine that any party complainant is entitled to an *award of damages* under the provisions of this Act for a violation thereof, *the Commission shall make an order directing the carrier to pay to the complainant the sum to which he is entitled on or before a day named.* (Italics ours.)

In the next paragraph it provided that—

> If a carrier does not comply with *an order for the payment of money* within the time limit in such order, the complainant, or any person for whose benefit such order was made, may file in the circuit court of the United States for the district in which he resides or, * * * a petition setting forth briefly the causes for which he claims damages, and the order of the Commission in the premises. Such suit in the circuit court of the United States shall proceed in all respects *like other civil suits for damages*, except that on the trial of such suit the findings and order of the Commission shall be prima facie evidence of the facts therein stated, * * * (Italics ours.)

It also provided that—

> If any carrier fails or neglects to obey *any order of the Commission other than for the*

> *payment of money,* while the same is in effect, any party injured thereby, or the Commission in its own name may apply to the circuit court in the district where such carrier has its principal office or in which the violation or disobedience of such order shall happen for an enforcement of such order * * *. If, upon such hearing as the court may determine to be necessary it appears that the order was regularly made and duly served, and that the carrier is in disobedience of the same the court shall enforce obedience to such order by a writ of injunction or other proper process, mandatory or otherwise, to restrain such carrier, * * * from further disobedience of such order, or to enjoin upon it or them obedience to the same. (Italics ours.)

It will be observed that these provisions relate to the *enforcing* of two kinds of orders, (1) those for the payment of money, and, (2) those other than for the payment of money.

The foregoing provisions were, in certain respects, amended by the Commerce Court Act of June 18, 1910, but such amendments are of no particular importance as an aid in construing the present paragraph (4) of Section 238 of the Judicial Code, except that jurisdiction of cases to enforce an order "other than for the payment of money" was transferred by that Act from the circuit courts to the Commerce Court, and no similar amendment was made transferring jurisdiction of

cases for the enforcement of an order "for the payment of money"; such jurisdiction remained after the Act of June 18, 1910, in the circuit courts.

It is thus made plain that when the Commission issues an order "for the payment of money" growing out of damages for violation of the Act, as in reparation cases, the complainant in whose favor the award is made is obliged to resort to what amounts to a civil action in court for the collection of his claim. The Commerce Court did not have jurisdiction of such actions and the district court has not now jurisdiction of such actions by reason of any such provision in the Commerce Court Act or the Urgent Deficiencies Act. In fact, orders for the payment of money are not "enforced" by any court proceedings but in the action by the complainant upon his claim he may introduce the order of the Commission awarding damages as "prima facie" evidence of the facts therein stated.

The Hepburn Act of June 29, 1906, passed 14 years prior to the Transportation Act of 1920, gave to the expression "an order for the payment of money" as applied to an order of the Interstate Commerce Commission a distinct meaning which did not and could not have embraced an order of the Commission in a recapture case. It is submitted that paragraph (4) of Section 238 of the Judicial Code does no more than to preserve the distinction between orders for the payment of money and orders other than for the payment of money as

originally drawn in the Act of June 29, 1906, and retained in the Commerce Court Act.

## ARGUMENT

### SUMMARY

This case is chiefly important because it presents for the consideration of the court the validity of the administrative measures and methods which the Interstate Commerce Commission, after mature consideration, regards as necessary to the effective operation of the recapture provisions of the Transportation Act. The principal ground of attack is that the order of the Commission is invalid because the recapture base or "value for rate-making purposes" upon which the excess earnings have been computed is less than it should have been and, in particular, that it is less than the hypothetical cost of reproducing the railroad on the basis of current commodity prices for the periods in question. The answer of the Commission to the principal attack is that the valuations it has fixed are the results of "due consideration" by the Commission of "*all* the elements of value recognized by the law of the land for rate-making purposes" as provided by the Act, and (quoting the language of this court) that reproduction cost, or "the present as compared with the original cost of construction," is only one of the many elements to be given "due consideration" in determining "fair value" or "reasonable value" or "value for rate-making purposes" or "rate base," which by the Act is made the recapture base upon which excess earn-

ings are to be figured; that the recapture of excess earnings is an exercise of the power to regulate rates and that its determination in the rate regulating process is a "legislative function," properly entrusted to an expert commission "appointed by law and informed by experience," whose judgment will be set aside by the courts only when it clearly results in the denial of constitutional rights; that its determination "is not controlled by artificial rules" and "is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of *all* relevant facts"; that it is "fundamental that the judicial power to declare legislative action invalid upon constitutional grounds is to be exercised only in clear cases" and that this is "true of asserted value as of other facts"; that if the alleged constitutional invalidity "rests upon disputed questions of fact, the invalidating facts must be proved"; that the "property" of a railroad is "dedicated" to the performance of a "function of government" and is to be valued in the light of the fundamental restrictions upon its use and disposition inherent in this dedication; that in determining the weight to be attached to current "reproduction cost" there is a clear and vital distinction between local public utilities and railroads, especially the railroads of the United States considered as a whole under the provisions of the Transportation Act; that this Act "introduced into the federal legislation a new rail-

road policy" in which the recapture of excess earnings is "the key provision of the whole plan"; that its fundamental purpose is to recognize the interstate railroads of the entire country as a national transportation system and to "foster, protect, and control" them so that they will most efficiently and economically perform the service to the public for which they were originally created as governmental agencies; and that by the Act "new rights, new obligations and new machinery were created" by which this new and constructive policy is to be made effective; that it imposes an unprecedented task on the Commission; that it "puts the railroad systems of the country more completely than ever under the fostering guardianship and control of the Commission," that "obviously Congress intended that a method should be pursued by which the task which it imposed upon the Commission could be performed;" that the Act is to be interpreted in no narrow legalistic fashion, but with constant regard to the economic and administrative factors involved, chief of which is such treatment of the capital already invested as will encourage and promote the procurement of the new capital upon which the whole future of the railroads as a national transportation system fundamentally depends; that the Act definitely and specifically provides that the Commission "shall give due consideration among other things to the transportation needs of the country and the neces-

sity (under honest, efficient, and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation;" that the treatment which has been given by the Commission since the passage of the Act to the existing investment has already produced unprecedented prosperity and financial stability for the railroads and is already proving attractive to new capital investment in railroad securities, stocks as well as bonds; that the continuance of these methods, as they have been continued in the *O'Fallon case*, will maintain and increase these highly desirable results, and certainly can not be regarded as "confiscatory," while the adoption of the theory of reproduction cost at current commodity prices as the *controlling* element in fixing "value for rate-making purposes" as the "recapture base" will have the opposite effect as well as being contrary to "the law of the land" and destructive of the beneficent purposes of the Transportation Act; that it is impracticable in administration inconsistent with the history and nature of railroad construction and development, grossly unfair to the public in a period of abnormally high commodity prices and disastrous to the railroads in a period of declining commodity prices.

As to the relatively minor objections made to the Commission's order, it is respectfully insisted (*a*)

that under the Act it is only when "the Commission finds" that two or more railroads are "under common control and management *and are operated as a single system*" that the value and net operating income of such railroads are to be computed for the group as a whole, and that the Commission has not only not made the finding which is the essential condition of any such treatment, but that the facts of record clearly show that these roads are operated separately, that their stockholders are not the same, and that there is no "common pocketbook" out of which the excess earnings of one can be or ever have been used for the benefit of the other, and that the decision of the Commission upon this particular point is not reviewable; (*b*) that the establishment of rates that will actually produce the "fair return" contemplated by the Act is not a condition precedent to the operation of the recapture provisions, as the Act did not intend anything whatever in the nature of a guaranty but simply directed the Commission to fix rates from time to time that would produce the results intended "as nearly as may be"; (*c*) that the Transportation Act became effective on and after the date of its passage on February 28, 1920, and that recapture must be effective on excess earnings after the effective date of the Act and not on August 26, 1920, when the first rate increases became effective; (*d*) that the "Reserve Fund" provisions of the Act and their application in the Commission's order do not

constitute the taking of private property without just compensation or without due process of law, because the railroad is "only a trustee for the excess over a fair return received by it" and "never had such a title to the excess as to render the recapture of it by the government a taking without due process," as expressly decided by this court; (*e*) that "the steps prescribed in the Act constitute a direct and indirect legislative fixing of rates," but that the procedure is adequately prescribed, and this court has repeatedly held that an administrative tribunal may fill in procedural details; (*f*) that interest on the recapturable excess is properly recoverable from the dates respectively when the several installments of such excess became payable to the Commisison under the statute, which was four months after the expiration of each period for which there was recapturable excess. By a cross appeal and the assignment of cross errors (R. 163–165) the Commission asks this court to reverse the decision of the trial court as to this feature of the order and to sustain the provisions of the Commission's order with respect to the payment of interest.

THE PROBLEM AND ITS SOLUTION BY THE COMMISSION

At the opening of our argument we wish to present the general situation which confronted the Interstate Commerce Commission, and with which it was familiar when it entered on its first application of the recapture provisions of the Transporta-

tion Act of 1920. No summary can adequately present the fair-minded, comprehensive, and far-seeing report of the Commission in this case. We urge the court to examine carefully the report itself. The following extract from pages 26 and 27 of the report (R. 60, 61) shows the point of view from which the Commission approached and solved its problem:

> There is here presented, in reality, a great national problem affecting public policy and welfare in a most profound way. In essence it is presented as clearly as it could be in the case of a railroad involving hundreds of millions of investment. In important aspects it is a problem which has never before been presented to either a commission or a court. We must carefully review the significance to the Nation of the decision which we make in this case in its bearings on the relation between all the railroads and all the people of the United States. It may well be that the valuation of railroads on a national scale requires the beginning of a new chapter in valuation.
>
> Commissions and courts, including the Supreme Court of the United States, have had to deal with a multitude of valuation cases, relating for the most part to local utilities—water, gas, electric and power properties. From a composite of all these cases various principles of valuation, frequently standing in striking contrast to one another, have been evolved by interested

parties according as their interest lies. Before we apply any of these so-called principles, we believe it to be vital to take a general survey of the entire situation, in order that conclusions may be reached which in their ultimate effect upon the Nation will be wise and just.

The basis of our authority in ascertaining and reporting valuations of common-carrier properties is an act of Congress passed in pursuance of its powers under the commerce clause of the Constitution. Upon the same powers rest the recapture provisions, which were designed by Congress to create a fund to be used "in furtherance of the public interest in railway transportation." Our problem in the administration of the valuation and recapture provisions is national in its scope and in its consequences, and is affected by a vast variety of considerations that either do not enter into, or are less easily perceived in, problems incident to the regulation of local public utilities. Limitations of issues, facts, or viewpoint impair many of the precedents which we are asked to follow by routes as divergent as the interests of those who make the requests.

Fundamentally the aim of the laws which we administer is the maintenance of an adequate national system of railway transportation, capable of providing the best possible service to the public at the lowest cost consistent with full justice to the private owners. In ascertaining values pursuant to section 15a we are, as has already been stated, directed to "give due consideration to all the

> elements of value recognized by the law of the land for rate-making purposes." The law of the land in this respect is, we believe, consistent with the aim above set forth.

The questions here involved were questions of law, as well as of fact, but they were to be correctly solved in no narrow, legalistic fashion. The law was to be interpreted in the light of the economic factors and purposes involved. In *Dayton-Goose Creek Ry. Co.* v. *U. S.*, 263 U. S. 456, 478, this court had declared:

> It * * * is insisted here that the power to regulate interstate commerce is limited to the fixing of reasonable rates and the prevention of those which are discriminatory; and that when these objects are attained the power of regulation is exhausted. This is too narrow a view of the commerce clause. To regulate in the sense intended is to foster, protect, and control the commerce with appropriate regard to the welfare of those who are immediately concerned as well as the public at large, and to promote its growth and insure its safety.

That this is no new view of the scope and purpose of Federal railroad regulation, is shown by the decision in *Texas & Pacific R. R. Co.* v. *Interstate Commerce Commission*, 162 U. S. 197, 211, 219, where the Supreme Court said:

> The scope or purpose of the act is, as declared in its title, to regulate commerce. It would, therefore, in advance of an examination of the text of the act, be reason-

able to anticipate that the legislation would cover, or have regard to the entire field of foreign and interstate commerce, and that its scheme of regulation would not be restricted to a partial treatment of the subject. *So, too, it could not be readily supposed that Congress intended, when regulating such commerce, to interfere with and interrupt, much less destroy, sources of trade and commerce already existing, nor to overlook the property rights of those who had invested money in the railroads of the country, nor to disregard the interests of consumers to furnish whom with merchandise is one of the principal objects of all systems of transportation.*

* * * * *

Commerce in its largest sense must be deemed to be one of the most important subjects of legislation and an intention to promote and facilitate it and not to hamper or destroy it is naturally to be attributed to Congress. The very terms of the statute that charges must be *reasonable*, that discrimination must not be *unjust*, and that preference or advantage to any particular person, firm, corporation, or locality must not be undue or *unreasonable, necessarily imply that strict uniformity is not to be enforced; but that all circumstances and conditions which reasonable men would regard as affecting the welfare of the carrying companies and of the producers, shippers, and consumers, should be considered by a tribunal appointed to carry into effect and*

*enforce the provisions of the act.* (Italics ours.)

This court had sustained the constitutionality of the Transportation Act in unanimous decisions which not only demonstrated the clear understanding of the Act by the court, but the court's approval of the essential policies and methods by which the new act was to be made effective. It had held in the *New England Divisions case*, 261 U. S. 184, 189, that the Act "introduced into the federal legislation a new railroad policy." The relatively negative policy of regulation to prevent abuse was converted into the affirmative policy of promoting development to secure adequate transportation service under effective control in the public interest, conceived in its broadest and most far-reaching aspects.

> The new purpose was expressed in unequivocal language. And to attain it, new rights, new obligations, and new machinery were created. The new provisions took a wide range. Prominent among them are those specially designed to secure a *fair return on capital* devoted to the transportation service. Upon the Commission, new powers were conferred and new duties imposed. (Italics ours.)

In *Dayton-Goose Creek Ry. Co.* v. *U. S.*, *supra* p. 478, this court had said:

> The new act seeks affirmatively to build up a system of railways prepared to handle promptly all the interstate traffic of the country. It aims to give the owners of the

> railways an opportunity to earn enough to maintain their properties and equipment in such a state of efficiency that they can carry well this burden. To achieve this great purpose, it puts the railroad systems of the country more completely than ever under the fostering guardianship and control of the Commission * * *

It will be noted that in the *New England Divisions case* this court attached special significance to the purpose of securing "a fair return *on capital* devoted to the transportation service," and in the *Dayton-Goose Creek case*, at p. 481 the court expressed its thought of what would constitute *a fair return on capital* as follows:

> By *investment* in a business dedicated to the public service the owner must recognize that as compared with investment in private business he cannot expect either high or speculative dividends, but that his obligation limits him to only fair or reasonable profit. (Italics ours.)

The Commission was keenly aware that governmental regulation of the railroads had hitherto been faced with the practically unsurmountable difficulty pointed out by this court and described in the Act, Sec. 15a(5), as being

> impossible (without regulation and control in the interest of the commerce of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to

> which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in the service of transportation * * *.

In other words, it was impossible to increase rates on competitive traffic for roads that needed an increase of earnings, because if the roads that competed for that traffic were held to lower rates the traffic would move on these other roads and increase their already high earnings without benefiting the more needy railroad. This *impossibility* is for the first time overcome by the express statutory provision that rates should be provided that would furnish a fair return upon the aggregate value of the property of the carriers as a whole or in suitable groups, and that if this resulted in the receipt of net railway operating income by any carrier "in excess of six per centum of the value of the railway property held for and used by it in the service of transportation," such excess shall be held to constitute "earnings in excess of a fair return," and that one-half of such excess shall be "recoverable by and paid to the Commission for the purpose of establishing and maintaining a general railroad contingent fund as hereinafter described."

In its analysis of the Act, this court said (p. 480):

> The recapture clauses are thus the key provision of the whole plan.

If, therefore, these recapture provisions can not be made practically effective for the accomplishment of the fundamental purpose of the Act, which is the protection and promotion of the interests of the entire public, including both users and owners of railroads, the whole plan will necessarily fail. As eminent railroad authority as Daniel Willard, President of the Baltimore & Ohio Railroad Company has said (*infra*, p. 104):

> This is the price which Congress may be said to have exacted for what has sometimes erroneously been called a guarantee.

Public opinion can not be expected to permit the railroad corporations and their stockholders to enjoy the very great benefits of the Transportation Act unless the public benefits contemplated by its "key provision" for the recapture of one-half of the excess earnings which the statute enables the more favorably situated railroads to receive, are in fact realized. Future experience may disclose the need for additional legislation with respect to the manner in which the recapture fund shall be utilized, but when the Commission approached its task in the *O'Fallon case* it knew that the creation of the fund was essential to the maintenance of the plan.

In carrying out this "key provision" of the "new railroad policy" the Commission was confronted with extraordinary difficulties; but it was encouraged by the declaration of the court that—

> Obviously Congress intended that a method should be pursued by which the task

which it imposed upon the Commission could be performed. *New England Divisions case, supra* (197).

It was, of course, imperative to overcome the administrative difficulties arising from the mere magnitude of the work of determining the "aggregate value" of all the railroads engaged in interstate commerce, and of revising each year the "value" of each and every one of these roads that might have excess earnings to be recaptured. It is a precise mathematical calculation that is to be made annually as to each of these roads. Here also the Commission was encouraged by the evident intention of Congress as indicated in the language of paragraph (4) of the Act, that there should be one preliminary aggregate value and one final aggregate value in making both of which the general valuation work of the Commission under Section 19a was to be given special recognition, expressed as follows:

> (4) For the purposes of this section such aggregate value of the property of the carriers shall be determined by the Commission from time to time and as often as may be necessary. *The Commission may utilize the results of its investigation under section 19a of this Act is so far as deemed by it available*, and shall give due consideration to all the elements of value recognized by the law of the land for rate-making purposes, and shall give to the property investment account of the carriers only that consideration

which under such law it is entitled to in establishing values for rate-making purposes.

*Whenever pursuant to Section 19a of this Act the value of the railway property of any carrier held for and used in the service of transportation has been finally ascertained, the value so ascertained shall be deemed by the Commission to be the value thereof for the purpose of determining such aggregate value.* (Italics ours.)

Given these valuations, the annual reports of the carriers as to capital additions and retirements, would furnish the Commission the basic information essential to the annual revisions. If the administration of the Act was to be workable it was essential that the original valuations be revised as little as possible consistently with the purpose and provisions of the Act and with fairness to the railroads and to the public, and that the revisions be based as much as possible on information currently available and not on controversial hearings based as much as possible on expert testimony as to purely hypothetical reproduction costs under constantly fluctuating commodity prices and constantly changing methods of construction and types of equipment.

When it reached the actual determination of the recapturable excess of the O'Fallon railroad (its first application of the recapture provisions), the Commission was also encouraged by the highly beneficial results already obtained from the rate

structure based by it on the preliminary aggregate value it had already established by utilizing its valuation work under Section 19a "so far as deemed by it available." In the *New England Divisions' case supra*, 190, 191, this court had described the unfortunate financial condition of the railroads prior to the passage of the Transportation Act as follows:

> The credit of the carriers as a whole had been seriously impaired. To preserve for the nation substantially the whole transportation system was deemed important. By many railroads funds were needed not only for improvement and expansion of facilities, but for adequate maintenance. On some continued operation would be impossible, unless additional revenues were procured. A general rate increase alone would not meet the situation. There was a limit to what the traffic would bear. A five per cent increase had been granted in 1914, *Five Per-cent Case*, 31 I. C. C. 351; 32 I. C. C. 325; fifteen per cent in 1917, *Fifteen Percent Case*, 45 I. C. C. 303; twenty-five per cent in 1918, *General Order of Director General No. 28*. Moreover, it was not clear that the people would tolerate greatly increased rates (although no higher than necessary to produce the required revenues of weak lines) if thereby prosperous competitors earned an unreasonably large return upon the value of their properties. The existence of the varying needs of the several lines and of their

> widely varying earning power was fully realized. It was necessary to avoid unduly burdensome rate increases and yet secure revenues adequate to satisfy the needs of the weak carrier.

It was to meet this situation that the Transportation Act had been passed. The results of the rate structure already established by the Commission as above stated had been an extraordinary improvement in the financial condition and credit of the carriers. Not only had net railroad revenues as a whole substantially increased, but new capital was becoming procurable by the sale of new securities in which for the first time in many years capital stocks instead of bonds were being offered. The Commission recognized that it was procurement of such new capital upon which the successful operation of the Transportation Act depends. The railroads were performing their functions with unparalleled efficiency and were in the soundest financial condition in their history.

The Commission was thus encouraged to continue the general methods already adopted, with such modifications as might be suggested by a more thorough consideration of all of the facts and elements affecting the situation. It should be clearly understood that the conclusion which the Commission finally reached in the O'Fallon case is based upon principles that would take from the railroads nothing that they now enjoy, but on the contrary

will tend strongly to confirm and stabilize existing conditions when it has been judicially approved.

The fundamental difficulty, however, which confronted the Commission was inherent in the complex operation of giving "due consideration to all the elements of value recognized by the law of the land for rate-making purposes." It was clear that this language has reference to the "fair value" rule of *Smyth* v. *Ames*, 169 U. S. 466, which, by a long series of judicial decisions remains "the law of the land." As originally enunciated, it was established as follows (pp. 546, 547):

> We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the *fair value* of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and *are to be given such weight as may be just and right* in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public con-

> venience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. (Italics ours.)

It is apparent that "fair value" is not "economic value" or "market value" or "commercial value," but an artificial judicial concept intended to express that value which is "just and right" to attribute to property which this court has repeatedly held was "dedicated" to the performance of a "function of government." "Economic value" must be either "value in use" or "value in exchange," and neither of these values can be predicated of the value of a railroad "for rate-making purposes." The value of railroad property to its private owners depends upon its earnings, and these are dependent upon the rates it is permitted to charge. Clearly in the regulation of these rates the earnings can not be capitalized to determine the value of the property. This vicious circle was long since repudiated by this court.

In repeated decisions this court had held that railroad rate regulation is a *legislative* function with the performance of which the judiciary had no right to interfere except to prevent confiscation or the invasion or destruction of rights secured by the supreme law of the land, and in *Smyth* v. *Ames* this court had said (p. 527):

> What are the considerations to which weight must be given when we seek to ascer-

> tain the compensation that a railroad company is entitled to receive and a prohibition upon the receiving of which may be fairly deemed a deprivation by legislative decree of property without due process of law? Undoubtedly, that question could be more easily determined by a commission composed of persons whose special skill, observation, and experience qualifies them to so handle great problems of transportation as to do justice both to the public and to those whose money has been used to construct and maintain highways for the convenience and benefit of the people.

In the creation of the Interstate Commerce Commission this policy was adopted, and in the *O'Fallon case* the Commission has endeavored to meet its great responsibility "so as to do justice both to the public and to those ***whose money has been used*** to construct and maintain highways for the convenience and benefit of the people." It has procured and received all available information as to every element suggested by the court, and has given "due consideration" to *all* of them. In the last analysis its decision must be a matter of expert judgment. In the *Minnesota Rate cases*, 230 U. S. 352, 433, this court said:

> The rate making power is a legislative power and necessarily implies a range of legislative discretion. We do not sit as a board of review to substitute our judgment

> for that of the Legislature or of the commission lawfully constituted by it as to matters within the province of either.

And again (pp. 452, 453):

> It is fundamental that the judicial power to declare legislative action invalid upon constitutional grounds is to be exercised only in clear cases. The constitutional invalidity must be manifest and if it rests upon disputed questions of fact, the invalidating facts must be proved. And this is true of asserted value as of other facts.

And again (p. 461):

> The value of the use, as measured by return, cannot be made the criterion when the return itself is in question.

And again (p. 434):

> The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment, having its basis in a proper consideration of all relevant facts.

In the *O'Fallon case*, 124 I. C. C. 3, the Commission gave the greatest consideration to "the present as compared with the original cost of construction," but it refused to accept as *controlling* the highly speculative cost of hypothetical reproduction of the railroads of the United States on the basis of current commodity prices. It pointed out the many evils which would result from the adoption

of such a policy. It expressed the opinion that (p. 41, R. 75) that—

> The value of the property of railroads for rate making purposes which is construed to be the value of property devoted to common carrier purposes upon which common carriers are entitled under the law to earn a fair return approaches more nearly the reasonable and necessary investment in the property than the cost of reproducing it at a particular time.

But the Commission did not adopt the "prudent investment" theory. Indeed, Mr. Commissioner Eastman in his separate concurring opinion, in which Commissioner McManamy joined, stated that he believed the results reached in the case were "somewhat too favorable to the carriers but not to an extent which warrants dissent" (p. 49, R. 83), and that he differed with the discussion in the majority opinion or report for the very reason (p. 58, R. 92) that the method if followed "in all probability would produce an amount greater than the honest and prudent investment in the property in actual existence on June 30, 1919."

An examination of the report will show that the Commission first carefully surveyed the whole broad field of its duties under the Act and then applied the principles and methods prescribed by the Act, as interpreted by the Supreme Court, to the particular case of the O'Fallon railroad. It held that the chief purpose of the Act was to develop the rail-

roads of the entire country as a national transportation system, to the end that they might furnish "the best possible service to the public at the lowest cost consistent with full justice to the private owners." (p. 27, R. 61.) It pointed out that paragraph (3) of Section 15a requires the Commission to

> give due consideration, among other things, to the transportation needs of the country, and the necessity (under honest, efficient, and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation. (pp. 38-39, R. 72, 73.)

It held that this end could be accomplished with justice and fairness to the railroads if, and only if, they could secure from the public the new capital necessary for the purpose, and that regulation which gives reasonable assurance of obtaining this result can not possibly be confiscatory but approaches most nearly what is "just and right" as between the public and the private interests involved. It held with the Supreme Court of Illinois (in *Utilities Commission* v. *Springfield Gas and Electric Co.*, 291 Ill. 209), that—

> The real test of the justice and reasonableness of any rate seems to be that it should be as low as possible and yet sufficient to induce the investment of capital in the business and its continuance therein.

It found that reliable evidence of original cost was not available as to the O'Fallon railroad just as it is not available as to most other railroads. It did have information available as to the present value of the right of way and lands under principles approved as to such property in the *Minnesota Rate cases, supra.* It had already assembled under Section 19a of the Interstate Commerce Act inventories and costs of construction and equipment applicable to these inventories over periods of five and ten years prior to 1914. It had been specifically authorized by the Transportation Act to give appropriate consideration to just this sort of information. From such information as was available as to the actual original costs, it was the judgment of the Commission that these were not as large as its reproduction estimates for the period preceding 1914. These estimates were arrived at—

> by consideration of the prices for labor and materials and the cost of constructing and equipping railroads in most instances during the five-year period ended June 30, 1914, but in certain other instances during periods of ten years or more ended June 30, 1914 (p. 21, R. 55).

The Commission's report (p. 37, R. 71) says:

> In our opinion these judgments have been reasonably liberal to the carriers. In all probability they are above rather than below the amounts which would have resulted if complete records had been available and the

investment theory of valuation had been employed.

Nevertheless it held that under the circumstances it was "just and right" that effective consideration be given to these higher figures. The Commission had its engineers tabulate the available data as to general commodity prices, etc., and found extraordinary fluctuations during the recapture periods under consideration, furnishing no reliable indication of future prices or trends. It found (p. 41, R. 75) that if the ratio indicated by the commodity price indices had been applied, the capital expenditures made in 1920 would have to be presumed to have cost approximately 2⅓ times (ratio 2.30) as much as if made in 1914, and that on the same hypothesis the property added in 1920 by these expenditures could have been "reproduced" in 1922 (ratio 1.57) for more than 30 per cent *less* than in 1920.

The record before the Commission showed that the alleged "new plateau of prices" for the recapture periods is serrated like a mountain range, and indeed the whole theory that prices are now on a "new plateau" where they will remain for a considerable time is contrary to all past experience. Immediately following the Civil War prices reached new heights only to descend with startling rapidity to new depths, which, as the Commission pointed out, explained the advocacy of reproduction cost by Mr. Bryan in *Smyth* v. *Ames* in 1897,

and the vigorous opposition of the railroads to the use of reproduction cost then and ever since until the abnormal condition produced by the World War has made it to their financial interest to reverse completely their position. The Commission points out that they were still urging that their "property investment accounts" were the only sound rate base at and even after the passage of the Transportation Act in 1920.

It was known to the Commission that (Report, p. 29, R. 63) "there was, in fact, very little new railroad construction" during the recapture periods in question, and that "synthetic estimates of cost of reproduction based upon statistics showing price and wage changes do not make allowance for improved methods of assembly and construction," and that, as the Commission had found in *Texas Midland Railroad,* 75 I. C. C. 1, 140, "the increase in the cost of labor and materials between 1900 and 1914 was largely offset by improvement in the art of construction," and that "how far there may have been a similar offset so far as costs in the period from 1920 to 1923 are concerned, is not disclosed of record," although the carriers were afforded every opportunity to present evidence upon this, as upon all other relevant matters. Indeed, the Commission says in its Report (p. 41, R. 75), that—

> Even if the cost of reproduction new in 1920 were to be regarded as a controlling element, there is not in the present record evi-

> dence showing what it might have cost to reproduce the property of the O'Fallon at that time. The only evidence in this respect is that of the relation of general prices in 1914 and in 1920 and the other recapture years. Costs of railroad building, owing to improvements in methods and economies thereby effected, did not vary greatly during the period of twenty years preceding 1914, although the prices of labor and material fluctuated. There is no testimony here as to how much it cost to build any railroad or any substantial part of one in any of the recapture periods, and for that reason it is impossible to make a comparison of such costs in the two periods. It is not safe to assume, as the O'Fallon has assumed, that costs of building railroads have varied in recent years in direct ratio to the variation in costs of commodities in general use, or in the costs of materials or labor generally.

**The commission did not adopt any "formula," but exercised "reasonable judgment" by giving "due consideration" to all "elements of value" and "all relevant facts"**

In their brief in this court, appellants appear to have vitally changed their position from that which they maintained before the Commission.

The Commission states in its report (p. 28, R. 62) that "the present as compared with the original cost of construction" was one of the factors indicated in *Smyth* v. *Ames*—

> and it is this factor, rechristened "cost of reproduction new at prices current on valua-

> tion date," that we are now urged to take as the basic measure of "fair value" to the exclusion of all other factors, except to the extent that it may be augmented by an allowance for something called "going value," which is vaguely defined in many ways.
>
> This insistence upon cost of reproduction new at current prices to the exclusion of everything else, or at least of everything that might tend to a lower value, calls for the closest scrutiny.

In this Court appellants unwarrantably state (brief, p. 50) that—

> the Commission's findings of value are based on a mathematical formula, the primary purpose of which was to determine the amount of investment in the carrier's property.

They restate their own position in the effort to avoid the advocacy of their own "formula," while, at the same time, maintaining its practical effect as a formula. They say (brief, p. 50):

> This Court has never held that value and cost of reproduction, less depreciation, if any, are synonymous. Appellants do not so contend. So to hold or contend would be to substitute another mathematical formula for that employed by the Commission. It is, however, a relevant fact to which due consideration must be given. In the majority of cases decided by this Court it is of all relevant facts that which has been accorded the greatest weight.

And again at page 64:

> This Court has never said that value is synonymous with cost of reproduction. The appellants do not so contend. Under the prior decisions of this Court, however, and under any rule the purpose of which is to determine *present* value, it is a relevant fact to be considered in connection with other relevant facts. It is the relevant fact which has most frequently been given *controlling* weight. (Italics ours.)

In the District Court brief, appellants inserted a similar disclaimer (pp. 49–50), but insisted (pp. 28 and 34) that decisions of this Court had declared "that *dominant* weight must be accorded to current reproduction cost." (Italics ours.)

The Commission adopted no "formula" or precise mathematical process in reaching its estimates or conclusions as to "value" for any of the recapture periods, nor can these estimates or conclusions, as stated in dollars, be analyzed so as to disclose any such mathematical process or formula. It is true that the Commission, in the process of giving "due consideration to all of the elements of value recognized by the law of the land for rate-making purposes," states in its report (pp. 37–40, R. 71–74) various figures applicable to valuations under various methods or theories of valuation; but it does not adopt any of the figures or any of the theories. It merely states what the figures would be respec-

tively under the different methods or theories, and states (report, p. 40, R. 74):

> Weighing the figures previously mentioned in the light of these considerations and the entire record, and viewing the carrier as a common carrier in successful operation and with an established business, we conclude that the value for rate-making purposes of the entire common carrier property of the O'Fallon on June 30, 1919, was $850,500.

No such mathematical process as that described in appellants' brief (pp. 52 to 56) was followed. The $850,500 was not built up nor arrived at in any such way. It was the result of the mutual adjustment and reconciliation of divergent views among the members of the Commission as must be true of all estimates based not upon "formulas" but upon "*reasonable judgment* having its basis in a proper consideration of *all* relevant facts." It was the result of "judgment" and not of a mathematical "formula." That this is true is, in effect, admitted by appellants (brief, p. 53) when they state that $850,500 is $32,660.88 in excess of any mathematical computation such as they unwarrantably attribute to the Commission. The conjecture in appellants' brief that the $32,660.88 "was *apparently* intended to cover appreciation, going concern and other intangible elements of value" is not borne out by anything the Commission says in its report or by any possible mathematical calcu-

lation discoverable from the record. Mathematical calculations produce exact figures—not approximations. It ignores the fact that the Commission had already stated in the sentence immediately preceding the one just quoted from page 40 (R. 74), that—

> *In the 1919 reproduction cost new and less depreciation schedules* are included as overheads such general expenditures incident to construction as expenses of organization, general officers, law, stationery, printing, taxes on structures and interest during construction, which, together with construction engineering, also included, aggregate 5.5 per cent of the total costs of reproduction less depreciation estimates. The inventoried quantities include large amounts added during operation, as a part of maintenance, which under a different method of valuation might be regarded as coming under the head of costs of appreciation. (Italics ours.)

This Court held in *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153, that allowances of this sort made unnecessary any further allowance for going-concern value.

Appellants ignore the express statement of the Commission in the O'Fallon Report (p. 37, R. 71)

> we have formed our judgment as to the fair basic single-sum value, *not by the use of any formula* but after consideration of all relevant facts. (Italics ours.)

What they do is to assert, unwarrantably (brief, p. 51), that

> The major portion of the carrier's property was valued at an amount assumed to represent the approximate investment therein, in the absence of reliable information as to original cost.

And again (brief, p. 76):

> With commendable frankness the Commission has rested its finding of value upon the investment theory of public utility valuation.

This not only contravenes the express statements of the Commission, but having set up this false deduction from the Commission's analysis of the information before it and from its comments upon that information as applied to various "elements" entitled to "due consideration," appellants proceed (brief, pp. 101–107) to demonstrate that this is not a proper deduction from the report as a whole, not only because (brief, p. 101, heading) the Commission's "findings of value are purely arbitrary and, on its own theory of value, unsupported by any evidence," but because (brief p. 107)—

> The Commission's "value" rests on such radically inconsistent bases that the result defies definition. It is consistent with no theory or standard.

All these difficulties disappear if the Commission's own statements, above quoted, are accepted

as correct statements of its use of "judgment" and not of "formula."

The comment of the Commission to the effect that its prior report in the *Texas Midland case* showed that

> the cost of producing and equipping a railroad in most parts of this country on June 30, 1914, was a fair average for at least the twenty years preceding.

does not show that it was the *purpose* of the Commission in that case to base value upon original cost. Indeed, appellants claim (brief, p. 102) that "This was mere dictum," and that (brief, p. 102):

> The report of its engineering section, offered by the Commission itself, and containing its estimate of the cost of reproduction of the carrier's property as of June 30, 1919, at 1914 prices, was not accompanied by any statement that its purpose was to determine the approximate investment in the carriers' property.

Appellants are not correct in claiming (brief, p. 73) that it is

> stated in the opinion of the minority Commissioners (R. 96), the *present costs of construction were* "established by competent testimony and undisputed."

or that

> An experienced and qualified valuation engineer called by the Commission as its witness gave testimony as to the relative *costs of construction* in 1914 and during each of the re-

> capture periods, based on authentic information derived from reliable sources, and enabling a correct and complete determination of the reproduction cost.

What the minority report by Commissioner Hall states (R. 96) is that

> the greatly enhanced costs of *material, labor, and supplies* during the periods of inquiry, here the recapture years, over those prevailing in the pricing period

were

> established by competent testimony and undisputed.

There was no evidence that such "enhanced costs" would justify the deduction that the cost of reproducing the railroads as a whole would have been correspondingly enhanced or that any prudent investor would have constructed or "reproduced" these railroads during the recapture periods at such prices. There was no evidence of any such original construction of railroads during the recapture periods and the Commission says (R. 75) not only

> There is no testimony here as to how much it cost to build any railroad or any substantial part of one in any of the recapture periods, and for that reason it is impossible to make a comparison of such costs in the two periods.

but also (R. 63):

> There was, in fact, very little new railroad construction in those years.

It is true that the figure of $850,500, having been arrived at as the value for rate-making purposes as of June 30, 1919, the Commission found no justification in the record for revising that figure as a basic figure for each of the recapture periods, but said (report, p. 42, R. 76):

> The method which we therefore find logical and proper for determining the value in the subsequent recapture periods is to add to or subtract from the 1919 value the net increases or decreases in the investment in property devoted to transportation service as determined from the carrier's returns to valuation order No. 3, with due regard to the element of depreciation.

Bearing in mind the abnormal prices and the violent fluctuations in these prices, the method thus followed was certainly not unfair to the carriers. It is the only method susceptible of practicable application if the recapture provisions of the Transportation Act are to be administratively workable.

It is of this total process in the application of "reasonable judgment" to the problem as a whole that the Commission said (report, p. 37, R. 71):

> In reality, the valuation problem is divided into two parts, which can be quite clearly distinguished, and the date when our valuation work under section 19a began marks roughly the division line between these two parts. Since that date we have required the carriers to report in detail all property changes and their costs, and these costs can

> be verified and checked. In the case of all property which came into existence prior to that date we have an inventory made by our own engineers, but no complete, reliable information as to original costs. The first part of our problem, therefore, is to determine upon a fair single-sum value for this older property. The second part of our problem is to bring this value down to any subsequent date, in the light of the property changes since our valuation work began, of which we have complete reports.

It is to be noted that this is precisely the method contemplated by the Transportation Act when it provides in paragraph (4) that the final valuation under section 19a shall be taken as the basic valuation, which necessarily is to be brought down to date by appropriate additions and deductions for each recapture period. The Commission's Report continues:

> The methods which we have followed in determining the basic values of the older property have been described at length in our valuation reports under section 19a. Briefly, we have had before us the cost of reproduction new of the structural portion of this property estimated on the basis of our 1914 unit prices, coupled with the knowledge that costs of reproduction so arrived at were not greatly different from the actual original costs. We have had complete information as to the depreciation of this property, in other words as to that portion

which in reality had ceased to exist because of the consumption of service life. We have had complete information as to the value of the railroad lands, based on the contemporaneous market values of adjoining and adjacent lands. We have had information, as complete as could be secured, relative to the financial and corporate history of the property, including its past earnings. We have further had such information as could be developed with reference to possible appreciation in the value of certain parts of the property because of better adaptability for use, and with reference to such other matters as the carriers desired to bring to our attention.

*From this accumulated information we have formed our judgment as to the fair basic single-sum values, not by the use of any formula but after consideration of all relevant facts.* In our opinion these judgments have been reasonably liberal to the carriers. In all probability they are above rather than below the amounts which would have resulted if complete records had been available and the investment theory of valuation had been employed. But the public, as represented by the Government, must bear some of the responsibility for the absence of records, and it is fair, under all the circumstances, that the basic valuations should be reasonably liberal. • • •

When it comes to bringing these basic valuations so arrived at down to any subsequent date, however, no good reason appears for

doing more than making the necessary adjustments to reflect the property changes which have since occurred and which have been fully reported to us, and to reflect any further depreciation of the property. By the adoption of such a method of bringing values down to date we shall achieve the stability of rate base which we have found to be essential to a wise and just plan of public regulation. The method has the further advantages, also, that it is simple and easy of application and involves no great expense or delay and that its results are capable of reasonably accurate forecast. It insures fair treatment to the investor because a fair return will be secured for every dollar that has gone into the project, provided, of course, that traffic is available. Whatever the price level may be, however severe the fluctuations, this method will result in yielding a fair return on every dollar invested and remaining in the property. This is the greatest assurance which can be held out to prospective investors. No stronger inducements can be offered in fairness to all the interested parties. * * *

It has been suggested that while it may be going too far to take current cost of reproduction as the basic measure of value, some weight ought to be given to changes in general price levels. Under the method outlined above we do give weight to such changes in so far as they have been reflected in prices paid for new construction or replacements, and we value lands at their pre-

> vailing market value. We know of no other way of giving weight to this factor which is not dependent upon caprice, unless full weight be given under the current reproduction cost doctrine. There is, in our judgment, no intermediate process possible which is capable of being applied by any rule independent of the caprice of those who apply it.

The validity of the Commission's conclusions does not depend upon the disclosure of the precise calculations by which they were reached. *P. C. C. & St. L. R. R. Co.* v. *Backus*, 154 U. S. 421, 436; *C. B. & Q. Ry. Co.* v. *Babcock*, 204 U. S. 585, 598.

The fact that the report of the Commission in the *O'Fallon case* contains a description of the general process followed by the Commission in giving "due consideration to *all* of the elements of value recognized by the law of the land for rate-making purposes" and stated various facts and figures which it had before it for its due consideration, is not equivalent, in any sense, to the adoption of a "formula."

The general method adopted by the Commission was approved in effect by this Court in *Georgia Railway & Power Co.* v. *R. R. Commission*, 262 U. S. 625. It is substantially that adopted in 1918 by former Justice Charles E. Hughes (who in 1913 wrote the opinion of the Supreme Court, of which he was then a member, in the *Minnesota Rate Cases*), when he reached the following decision as referee in the *Brooklyn Gas case*, P. U. R. 1918 F. 335, 347:

While it is important to consider the cost of reproduction in determining the fair value of a plant for rate-making purposes, it can not be said that there is a constitutional right to have the rates of a public service corporation based upon the estimated cost of the reproduction of its property at a particular time regardless of circumstances. To base rates upon a plant valuation simply representing a hypothetical cost of reproduction at a time of abnormally high prices due to exceptional conditions would be manifestly unfair to the public, and likewise to base rates upon an estimated cost of reproduction far lower than the actual bona fide and prudent investment because of abnormally low prices would be unfair to the company. * * * If, however, we are not to take the actual cost of reproduction at the present time, or within a year or so, because it would be an abnormal cost, and we are to seek some fairer basis of estimating the value of plaintiff's property for the purpose of determining the validity of rates, it would be difficult to find any basis more just than the appraisal carefully made by public authority and based on reproduction cost before the outbreak of the European war, with proper consideration of the actual investment since that time.

**Opinions of dissenting commissioners**

That the report and decision of the majority of the Commission is sound as a matter of economic principle and public policy is the evident opinion

of at least two-thirds of its members, as will be apparent from an examination of the majority and minority reports or opinions themselves. The minority commissioners do not dissent from the basic valuation as of June 30, 1919. Such differences as exist relate to the question whether certain decisions of this Court compel the Commission to give greater weight to reproduction costs on account of changes in general price levels or in the purchasing power of the dollar during the recapture periods. This is the principal contention made by the railroad counsel and upon which the Court is asked to review the ruling of the Commission.

Commissioner Hall has written a dissenting opinion in which Commissioners Aitchison, Woodlock, and Taylor concur. This opinion does not attempt to meet the reasoning of the majority opinion as to the unsoundness of making reproduction cost the dominant or determining factor in fixing values for recapture purposes. It forgets the broad scope of the Commerce Clause as interpreted by this Court in the cases cited early in this brief and proceeds on purely legalistic lines. It says (R. 93, 94, 97, 98):

> At the risk of appearing to lack vision we venture the reminder that the function of this commission is not to act as an arbiter in economics, but as an agency of Congress to apply the law of the land to facts developed of record in matters committed by Congress

> to our jurisdiction. We may, indeed, in our annual reports to that body, recommend needed changes in legislation, but we may not make those changes ourselves. This dissent is from the refusal of the majority to apply that law to the O'Fallon. * * * If the majority, while developing with manifest earnestness and sincerity the reasons by which they are persuaded, had nevertheless recognized the constraint of the law thus far declared and reached conclusions in harmony with it, nothing would have been lost in the presentation and where we were in error the Supreme Court could have set us right. If the law needs change, let those who made it change it. Our duty is to apply the law as it stands.

Commissioner Aitchison, however, adds in a separate opinion (p. 64, R. 98):

> In much that is stated by the majority as to the effect of the valuation rule contended for by the carriers, I unreservedly concur; and my dissent as expressed by Commissioner Hall *on purely legal grounds* does not indicate noncurrence as to these other important considerations, chiefly economic in their character so forcefully discussed by the majority. (Italics ours.)

This dissent the majority of the Commission forestalled by pointing out that the principle of determining railroad value has never come before the Supreme Court in the form in which it is presented by the Transportation Act; that the decisions of this Court are not in harmony with each other; that

none of these decisions hold that "spot" reproduction costs are determinative of "value": that much of the language with respect to the use of reproduction costs in determining value upon which the carriers rely, is *obiter dicta*, and that the practical consequences of following this language would be so serious that the Commission would be derelict in its duty if it did not present for the mature consideration or (if necessary) reconsideration of the court the practical dilemma in which the Commission is placed so that the court may realize that if reproduction costs as effected by current prices of labor and materials are to be given "due consideration," it must be in some such way as the Commission has adopted in the O'Fallon case, unless, indeed, the court sees fit to say to the Commission that "spot" reproduction costs shall be the exact or approximate measure of the "value" except in the possible but extraordinary cases where a particular reason can be found and stated for departing from that measure.

Commissioner Woodlock based his objection to the results reached by the majority of his colleagues upon the "depreciated dollar theory" which we shall discuss later. The interesting feature, however, of his dissenting opinion is his concurrence in the test that the reasonableness of rate regulation is to be judged by its effect upon future investment. He says (R. 100):

> In fully competitive enterprises the rate of return tends at all times to circle around

> the point where it will just suffice to attract capital into the industry when and as needed. This being so, it follows that railroad rates and fares should, under regulation, be so adjusted that the return offered will tend to be *high enough* to attract the investor's capital—and *no higher*. (Italics Commissioner Woodlock's.)

**THE QUESTIONS AT ISSUE ARE QUESTIONS OF STATUTORY CONSTRUCTION—THERE IS NO CONFISCATION**

*If the statute is constitutional* (and this court has held that it is), and *if the Commission has complied with the statute*, there is no confiscation in this case. The figures for which appellants have contended, and the argument which is based on them, beg the question because they depend upon the assumption that the Commission violated the statute, and if this is true it disposes of this case without raising any constitutional question. We do not contend and we have never contended that the question of statutory construction is not before the court.

In its amended petition, the O'Fallon claims a minimum value of $1,350,000. The income remaining to the O'Fallon after recapture of the amounts indicated in the order of the Commission for the three full recapture periods and the percentage relation of such remaining income to the value claimed by the O'Fallon itself is as follows: 1921, $117,624.16 or 8.71 per cent on $1,350,000; 1922, $111,927.96 or 8.39 per cent; and 1923, $113,899.37 or 8.44 per cent. If the higher value which might

result from the application of current commodity prices as set forth at page 31 of the Commission's Report be substituted for the claimed value of $1,350,000, the net excess income, *after recapture*, would amount to 7.52 per cent, 8.76 per cent, and 8.10 per cent for the same three years, respectively. It is clear from an examination of these figures that if the statute has been properly construed by the Commission, no constitutional issue of confiscation is involved. No court has ever held that a railroad must be given a return in excess of 8 per cent upon the value of its property in order to prevent confiscation. This court approved the recapture or reserve of all excess earnings above 6 per cent in the case of *Dayton-Goose Creek Ry Co., supra*, and said (p. 486) that a return of "about 8 per cent" could "hardly be called confiscatory."

Appellants support by no authority their claim that the amount retained by the O'Fallon in the "reserve fund" is not to be considered income in determining whether the Commission's order is confiscatory on the ground that any impairment of the present unrestricted use of its net operating income amounts to "confiscation." This Court has held that reasonable regulations which have an even more substantial effect upon the present unrestricted use of earnings are within the power of Congress and within the power of the Commission under broad statutory authority with respect to accounting

In *Kansas City Southern Railway Company* v. *United States*, 231 U. S. 423, it was claimed (p. 455) that enforcement of such regulations would

> impair the credit of appellant by diminishing apparent earnings, preventing continuance of dividends upon preferred stock and keeping down the aggregate value of "assets" upon the property accounts.

and that (p. 453)—

> the effect of the regulations, if complied with, is to deprive the preferred stockholders of a considerable part of the non-cumulative dividends from the net earnings of the company, to which they would otherwise be entitled.

The Court sustained the regulations on the broad ground that (p. 453)—

> the Interstate Commerce Act deals with the carrier in its capacity as a servant of the public, and as a distinct entity, amenable to the legitimate regulation of Congress and the Commission.

and the effect of the decision is stated in the syllabus (p. 424):

> *Semble*, that requiring stockholders to forego dividends for a period so that the amount not divided be spent in bettering the condition of the property, thus giving them greater security for dividends in the future, does not amount to an unlawful taking of property within the meaning of the Fifth Amendment.

The provisions of the Transportation Act with respect to the "reserve fund" are merely reasonable requirements that the carrier shall not dissipate its earnings so as to impair its continuance as an effective agency of transportation. It is merely required to establish an exceedingly reasonable reserve in its own interest and in the interest of the public service which the railroad is created to perform. This "reserve fund" is freely to be used for purposes which are essential to the maintenance of the credit of the carrier and the continuance of the service. This clearly appears from the language of Section 15a, paragraphs (7) and (8), which read:

> (7) For the purpose of paying dividends or interest on its stocks, bonds or other securities, or rent for leased roads, a carrier may draw from the reserve fund established and maintained by it under the provisions of this section to the extent that its net railway operating income for any year is less than a sum equal to 6 per centum of the value of the railway property held for and used by it in the service of transportation, determined as provided in paragraph (6); but such fund shall not be drawn upon for any other purpose.
>
> (8) Such reserve fund need not be accumulated and maintained by any carrier beyond a sum equal to 5 per centum of the value of its railway property determined as herein provided, and when such fund is so accumulated and maintained the portion of its excess in-

come which the carrier is permitted to retain under paragraph (6) may be used by it for any lawful purpose.

FINANCIAL CONSEQUENCES INVOLVED

It is not necessary to dwell upon the magnitude of the financial results to the public as well as to the railroads which depend upon the decision in this case.

The Commission fixed the recapture base of the O'Fallon railroad at approximately $850,000 for 1920. The railroad claims that this should be increased to at least $1,350,000, or approximately 60 per cent. In 1920 the Commission, using substantially the method of valuation it has followed in the *O'Fallon case* (as heretofore admitted by appellants), estimated the value of all the interstate railroads for rate-making purposes at $18,900,000,000. Substantially the same principles must necessarily be applied to all railroads in determining the "fair value" or recapture base. If the contentions of the appellants are sound, the $18,900,000 must, therefore, be increased approximately 60 per cent or over $11,000,000,000, in order to ascertain the recapture base which is also the rate base upon which rates must produce "a fair return" in order to avoid "confiscation."

Inasmuch as rates must in any event be increased if necessary to cover the cost of operation, which is generally regarded as normal at approximately 70 per cent of the gross receipts, the net increase of

rate levels that might be required to avoid confiscation under the current reproduction cost theory as compared with the O'Fallon method, would be about 30 per cent of the 60 per cent above indicated, or 18 per cent over rates which would not be confiscatory under the O'Fallon theory. This 18 per cent, however, can not be brought about by horizontal increase in the rate level. Many classes of freight will not stand an increase of rates. It is at least probable that any increase in passenger rates would diminish the net earnings. *In Ex Parte* 74, 58 I. C. C. 220, 241, the Commission stated:

> That the carriers contend that it is uncertain whether an increase in the general level of passenger fares will yield increased revenue proportionate to the increase in the fare level, because of possible reduction in travel following a material increase in fare.

A much smaller increase in passenger fares than in freight rates was, therefore, authorized at the time by the Commission. In *Reduced Rates 1922*, 68 I. C. C. 676, the Commission found that there had actually been a decrease in revenue passenger miles in 1921. In view of the admission then made by certain railroads that the rates were then "too high and must come down" it is apparent that the only real restraint upon the enormous rate increase upon certain classes of traffic that would be necessary if "confiscation" is to be avoided under the reproduction cost theory, would be the enlightened

self-interest of the carriers and the function of the Commission would be reduced to the prevention of discrimination between shippers and localities. The use of "spot" or current reproduction cost as determinative of the rate base is either sound or unsound. Its advocates are simply reluctant to carry their theory to its logical conclusion.

In their brief in this Court, appellants characterize the Commission's observations in respect of this matter as a "scare" argument. They do not deny that the *legal* effect of the "current reproduction cost" theory, if applied to the railroads as a whole, as they seek to have it applied to the O'Fallon, would increase the *rate base* approximately 60 per cent (except that they say 57 per cent) above the $18,900,000,000 tentatively assumed by the Commission in 1920. Their contention would mean that rates which do not produce a fair return (say 6 per cent) upon this increased rate base would be confiscatory, except as the Commission may take into consideration the proviso in the rate-making section (paragraph 2) which modifies that section by providing

> that the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable and to prescribe different rates for different sections of the country. (Appellants' brief, p. 92.)

The only real limitation of their *constitutional claim* which they admit is that it would not be un-

constitutional to stop increasing rates when further increase would stop traffic. They say (brief, p. 98):

> If, with such readjustment of individual rates as the Commission is authorized to make under the proviso to paragraph (2) of Section 15a, it [commerce] continued to move freely, there would appear to be no reason why the price of railroad transportation, like the price of other commodities and services, should not be measured in terms of the present dollar.

They also say (appellants' brief, p. 93):

> Between the self-interest of the carriers in the preservation of their traffic and the Commission's control of the situation under the proviso of paragraph 2, it may, we believe, be fairly assumed that no untoward consequences would result in the way of exorbitant transportation charges by adherence to the present value theory.

This, we submit, is an admission of the contention we have just made as to the financial consequences of the adoption of their theory. It is in no way avoided by the reference to the rate increases authorized by the Commission in 1920 or the reduction made in 1922. In neither of these instances was the Commission proceeding upon the "current reproduction cost" theory; and the reductions were acquiesced in by the carriers, who contented themselves with urging before the Com-

mission the adoption of their "property investment accounts" as the basis for rate-making.

Appellants make erroneous use of the statement by Commissioner Taylor that—

> The proportion of labor, material, and taxes for all class I railroads of the United States for the last year for which the record is complete amounted to practically 82% of the total disbursement out of operating revenues for these costs *and for interest and dividends.* (Italics ours.)

This 82 per cent is a percentage of "disbursements" and not of operating revenues, as appellants themselves state. (Brief, p. 95.) What the Commission used was the assumed normal 70 per cent of *operating revenues* required for operating expenses, *exclusive of interest and dividends.* Appellants refer (brief, pp. 96, 97, and 98) to the *41st Annual Report of the Interstate Commerce Commission,* December 1, 1927, from which they quote certain figures in the attempt to show that in the year 1926 the net railway operating income of all railroads was a little less than 20 per cent of their aggregate income, but Table VI of the same report, the same table from which they quote, states that the total operating expenses for the year 1926 was 73.15 per cent of the operating revenues.

We are not particularly concerned with the niceties of any of these calculations. The effect of the application of appellants' "current reproduction cost" theory to the rate base, and therefore to the rates (if confiscation is to be avoided), would be

sufficiently serious up to the point at which it would encounter the law of diminishing returns and the restraints imposed by the carriers' recognition of enlightened self-interest.

### EXTENT OF JUDICIAL REVIEW

It is so thoroughly established that the regulation of railroad rates is a *legislative* function that it is necessary here only to cite the *Minnesota Rate cases, supra*, p. 433, where this Court said:

> The rate-making power is a legislative power and necessarily implies a range of legislative discretion. We do not sit as a board of revision to substitute our judgment for that of the legislature, or of the commission lawfully constituted by it, as to matters within the province of either.

In our Historical Review of the Decisions of the Supreme Court relevant to the fundamental issues here involved (printed later in this brief), the basis and development of this recognition of legislative power are more fully presented. In applying the principle this court has made it clear that the judiciary is not concerned with the mental processes or the reasoning by which the Commission arrives at its conclusions. It is concerned only with the results which the Commission reaches by the action it takes. In *Virginian Railway Co.* v. *U. S.*, 272 U. S. 658, 665, 666, decided December 31, 1926, it was said:

> This court has no concern with the correctness of the Commission's reasoning, with

> the soundness of its conclusions, or with the alleged inconsistency with findings made in other proceedings before it.

The court cited *Interstate Commerce Commission* v. *Union Pacific R. R. Co.*, 222 U. S. 541, in support of the declaration just quoted. In the case thus cited it was held (p. 547):

> In determining these mixed questions of law and fact, the court confines itself to the ultimate question as to whether the Commission acted within its power. It will not consider the expediency or wisdom of the order, or whether, on like testimony it would have made a similar ruling.

The principles and authorities are summarized as follows in *U. S.* v. *Berwind-White Coal Mining Co.*, 274 U. S. 564, 580, decided May 31, 1927:

> There was ample evidence to support the Commission's findings. It is not for courts to weigh the evidence introduced before the Commission, *Western Paper Makers Chemical Assn.* v. *U. S.*, 271 U. S. 268, 271; or to enquire into the soundness of the reasoning by which its conclusions are reached, *Interstate Commerce Commission* v. *Illinois Central R. R. Co.*, 215 U. S. 452, 471; *Skinner & Eddy Corporation* v. *U. S.* 249, U. S. 557, 562; or to question the wisdom of regulations which it prescribes. *U. S.* v. *New River Co.*, 265 U. S. 533, 542. These are matters left by Congress to the administrative 'tribunal appointed by law and informed by experience,' *Illinois Central R. R. Co.* v.

*Interstate Commerce Commission*, 206 U. S. 441, 454.

The proper limits of judicial authority would probably be exceeded were the courts to undertake to tell the Commission how much weight the Commission shall give to one or another "element" in order to constitute "due consideration" of "*all the elements of value recognized by the law of the land for rate-making purposes.*" Certainly the courts should not seek to take over the function of the Commission.

In *Smyth* v. *Ames*, the Supreme Court said (p. 527):

> What are the considerations to which weight must be given when we seek to ascertain the compensation that a railroad company is entitled to receive, and a prohibition upon the receiving of which may be fairly deemed a deprivation by legislative decree of property without due process of law? Undoubtedly that question could be more easily determined by a commission composed of persons whose special skill, observation, and experience qualify them to so handle great problems of transportation as to do justice both to the public and to those whose *money* has been used to construct and maintain highways for the convenience and benefit of the people. (Italics ours.)

In *Illinois Central Railroad Co.* v. *Interstate Commerce Commission*, 206 U. S. 441, 454, the Court said:

The findings of the Commission are made by law *prima facie* true. This court has ascribed to them the strength due to the judgments of a tribunal appointed by law and informed by experience.

In *City of Knoxville* v. *Knoxville Water Company*, 212 U. S. 1, 8, 17, 18, the Court said:

There can be at this day no doubt, on the one hand, that the courts, on constitutional grounds, may exercise the power of refusing to enforce legislation, nor, on the other hand, that that power ought to be exercised only in the clearest cases. The constitutional invalidity should be manifest, and where the invalidity rests upon disputed questions of fact the invalidating facts must be proved to the satisfaction of the court. • • • It can not be doubted that, in a clear case of confiscation, it is the right and duty of the court to annul the law. Thus, in *Reagan* v. *Farmers' Loan & Trust Company*, 154 U. S. 362, where the property was worth more than its capitalization, and upon the admitted facts the rates prescribed would not pay one-half the interest on the bonded debt; in *Covington, etc., Turnpike Co.* v. *Sandford*, 164 U. S. 578, where the rates prescribed would not even pay operating expenses; in *Smyth* v. *Ames*, 169 U. S. 466, where the rates prescribed left substantially nothing over operating expenses and cost of service; and in *Ex parte Young, supra*, where on the aspect of the case which was before the court,

> it was not disputed that the rates prescribed were in fact confiscatory, injunctions were severally sustained. But the case before us is not a case of this kind (p. 17), * * * The courts, in clear cases, ought not to hesitate to arrest the operation of a confiscatory law, but they ought to refrain from interfering in cases of any other kind.

In the *Minnesota Rate Cases, supra,* p. 433, the Court said:

> The rate-making power is a legislative power and necessarily implies a range of legislative discretion. We do not sit as a board of revision to substitute our judgment for that of the legislature, or of the commission lawfully constituted by it, as to matters within the province of either.

Appellants have stressed the decision in *Ohio Valley Water Company* v. *Ben Avon Borough*, 253 U. S. 287, as holding that on the issues of value and confiscation the court is not limited to the narrower judicial review applicable to mere administrative orders of the Commission and that they are entitled to the independent judgment of the court on the record before the Commission as to both the law and the facts. We respectfully insist that the decision in the *Ben Avon case* has been misconceived. That case does not hold that the court will or should sit as a board of review to substitute its judgment for that of the Legislature or its agency, the Commission. (See cases already cited by us.)

In *San Diego Land & Town Co.* v. *Jasper*, 189 U. S. 439 (pp. 441–442), the court said:

> In a case like this we do not feel bound to reexamine and weigh all the evidence, although we have done so, or to proceed according to our independent opinion as to what were proper rates. It is enough if we can not say that it was impossible for a fair-minded board to come to the result which was reached.

This decision is not overruled in the *Ben Avon case*. In that case the State of Pennsylvania had enacted a public service law, which was held by the State Court to prevent absolutely any judicial review of the action of the State Commission. The Supreme Court held that a State statute *so interpreted* was unconstitutional, and that the utility could not be deprived of the right of judicial review. The court did not hold that it was bound to weigh the evidence and form an independent conclusion as to both the law and the facts; it simply upheld its right to do so. That it did not intend to depart in any way from the principle laid down in the *San Diego case*, above quoted, is evidenced by its reference to that case in the cases of *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, and *Georgia Ry. & Power Co.* v. *Railroad Commission*, *supra*, both decided after the *Ben Avon case*. The following cases, also decided since the *Ben Avon case*, uphold similar principles: *Seaboard Air Line* v. *United States*, 254 U. S. 57, 62; *New England Divi-*

*sions case,* 261 U. S. 184, 204; *United States* v. *New River Co.,* 265 U. S. 533, 540; *Virginian Ry. Co.* v. *United States,* 272 U. S. 658; *C. R. I. & P. Ry. Co.* v. *United States,* 274 U. S. 29; *United States* v. *Berwind-White Coal Mining Co., supra.*

While the tendency of some recent decisions may seem to confine the exercise of judgment or discretion by the Commission within narrower limits and to emphasize the use of reproduction cost, careful consideration of these and other decisions will show that the court intends no such inference, and certainly does not intend to apply to railroads and to the recapture provisions of the Transportation Act what it has said in particular cases with respect to particular local public utility valuations.

### VALUE FOR RATE-MAKING PURPOSES

In construing the phrase "value for rate-making purposes" it is essential to go back to its origin in the "fair value" rule of Smyth v. Ames, decided in 1898, which rejected alike the "current reproduction cost theory" urged upon this court by Mr. Bryan, and the contention of the railroads as stated by the court (p. 543):

> In the discussion of this question the plaintiffs contended that a railroad company is entitled to exact such charges for transportation as will enable it at all times not only to pay operating expenses but also to meet the interest regularly accruing upon all its outstanding obligations, and justify a dividend upon all its stock; and that to prohibit it

from maintaining rates or charges for transportation adequate to *all* those ends will deprive it of its property without due process of law and deny to it the equal protection of the laws.

With respect to this claim the court said (p. 544):

In our opinion, the broad proposition advanced by counsel involves some misconception of the relations between the public and a railroad corporation. It is unsound in that it practically excludes from consideration the fair value of the property used, omits altogether any consideration of the right of the public to be exempt from unreasonable exactions, and makes the interests of the corporation maintaining a public highway the sole test in determining whether the rates established by or for it are such as may be rightfully prescribed as between it and the public. A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the state. Such a corporation was created for public purposes. It performs a function of the state. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public. It is under governmental control, though such control must be exercised with due regard to the guaranties for the protection of its property. *Olcott* v. *The Supervisors*, 16 Wall. 678, 694; *Sinking Fund Cases*, 99 U. S. 700, 719; *Cherokee Na-*

> *tion* v. *Southern Kansas Railway*, 135 U. S. 641, 657. It can not, therefore, be admitted, that a railroad corporation maintaining a highway under the authority of the state may fix its rates with a view solely to its own interests and ignore the rights of the public. But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the fair value of the property used for the public or the fair value of the services rendered, but in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders.

Practically ever since that decision destroyed these extreme claims, the railroads have contended persistently up to the passage of the Transporation Act, that their "property investment accounts" should be the controlling factor in determining the rate base or "value for rate-making purposes" and it is for that reason that the Transportation Act provided in paragraph (4) that the Commission:

> shall give to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing value for rate-making purposes.

It may be said in passing, that the chief objection to the use of the "property investment account" has always been that it did not correctly set forth either the actual or the "prudent" investment.

This "fair value" rule of *Smyth* v. *Ames*, has been and still is vigorously criticized by jurists and economists on the ground that it can not be submitted to any rational test by which the accuracy of its application can be determined, and must always rest in what is called the exercise of "reasonable judgment." "Fair value" is an artificial judicial concept which does not correspond to any economic concept of "value." There are only two kinds of "value" known to the economists—value in use and value in exchange. Neither of these kinds of "value" can be predicated of a railroad "for rate-making purposes." Clearly, value in use can not be taken as the rate base in the process of determining the rates to be charged in the use. The vicious circle has been recognized and definitely rejected by this court. "Value in exchange" must also be rejected as inapplicable to property "dedicated" to the performance of a "function of the state" and which is not commonly exchanged and can not be "exchanged" or diverted from the performance of its governmental function except "when it develops with reasonable certainty that future operations must be at a loss.

> *Railroad Commission* v. *Eastern Texas R. R.*, 264 U. S. 79, 85.
>
> *Wolff Packing Co.* v. *Court of Industrial Relations*, 262 U. S. 522, 543.

Nevertheless, this court has steadfastly adhered to the "fair value" rule of *Smyth* v. *Ames*, and has resisted every effort to induce it to define "fair

value" or to formulate any precise method for its determination. It has indeed declared in many cases, notably in the *Minnesota Rate Cases, supra* (p. 434) that—

> The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts.

This court also held in the case last cited and in many other cases, that railroad rate regulation is a "*legislative* function," the performance of which is properly entrusted to an expert commission "appointed by law and informed by experience," whose judgment is subject to review by the courts only for the purpose of seeing that it does not violate the statutes under which it acts and that the result is not arrived at by what would amount to a denial of "due process of law" or to the "taking of private property for public use without just compensation."

Seldom does this court render a decision on this subject without recognizing the wide range of discretion within which the legislative power is lawfully exercised by the Commission, or without recognizing the governmental character of the service to which railroad property is "dedicated."

Railroad regulation is not merely an exercise of the "police power," nor is it based merely upon the principle that the "business" is impressed with the public interest like a mill or an inn, and is there-

fore subject to regulation only while the owner of the property sees fit to use it for that business, from which business the owner can freely withdraw his property whenever he wishes. The delegation of the power of eminent domain to a railroad corporation as well as the levying of taxes and the making of gifts or grants in their aid was sustained in the courts solely and expressly upon the ground that the railroad corporation was an agency of government, created to perform a function of the state, and that in the language of *Redfield on Railways*, adopted (without quotation marks) by the Supreme Court in *Pine Grove* v. *Talcott*, 86 U. S. 666, 676:

> Though the corporation was private its work was public, as much so as if it were to be constructed by the State.

When, therefore, this court used in *Smyth* v. *Ames* the language already quoted that the railroad "performs a function of the State," and more recently in the *Dayton-Goose Creek case* said:

> By *investment* in a business *dedicated to the public service*, the owner must recognize that as compared with investment in a private business he can not expect either high or speculative dividends, but that his obligations limits him to only fair or reasonable profit (p. 481).

these were not mere perfunctory words. The whole railroad law of this country has from the beginning been based upon the principle thus enunciated.

The difficulty, if not impossibility, of valuing such property by any economic standards is apparent. Railroads are seldom, if ever, bought and sold, except under foreclosure proceedings, which, of course, do not constitute an open market. Leases are more frequent, but even these seldom afford any criterion of value, although the Commission stated in its report in the present case that (p. 34, R. 68):

> It could, if it were necessary, be abundantly shown that there have been any number of cases where the private owners of railroad property have very willingly accepted rentals for long terms of years at figures materially below the return which would fix the limit of confiscation if the current reproduction cost doctrine were accepted.

It may also be noted that under the contract between the railroads and the American Railway Express Company, provision has been made for the acquisition of the physical assets of the latter on March 1, 1929, at "cost less depreciation." (*Wall Street Journal* and the *Railway Age*, July 21, 1928.)

Much confusion of thought has resulted from the acceptance of the statement that "railroads are private property," without keeping in mind the important limitations within which only is that statement correct. The *title* is private, but the *property* is "dedicated" *ab initio* to the performance of "a

function of government." From this *dedication* there flow certain peculiar and drastic limitations and restrictions upon the private title. When we are seeking to ascertain "value for rate-making purposes" we are concerned with the value of the interest of the private holder of this peculiarly limited and restricted title. We are not actually taking the physical property for public use. We are affecting the enjoyment of the use of the physical property by the holder of the private title. Only in that sense can it be claimed that "private property is being taken for public use without just compensation." "Property" is a creature of the law. It is a legal concept. It is not physical things. It is the control or dominion over physical things which the holder or "owner" has by law the right to exercise. If there are lawful restrictions upon this control and use these restrictions necessarily affect and limit "fair value," as well as the "value in use" and the "value in exchange" of the "property" with respect to which the "just compensation" is to be determined.

In *Railroad Co.* v. *Catholic Bishop et al.*, 119 Ill. 525, 529, it was said:

> Where the owner of land is restricted by statute, or by the provisions of the instrument under which he holds his title * * * to a particular use of it so that he can not lawfully apply it to any other use, the measure of his compensation, where the land is taken by condemnation, will be its value to

> him for the special use, to which he is so restricted.

In *C., B. & Q. R. R. Co.* v. *City of Chicago*, 149 Ill. 457, 461, the same court said:

> Where lands are restricted by law or by the terms of a grant to a particular use, the measure of compensation in a condemnation proceding to the owner for the lands taken will be their value to him for the special use to which they are restricted.

So clearly were the consequences of this fundamental principle recognized that the court held

> that there was no error in excluding testimony offered for the purpose of showing the general salable value of the right of way included in the crossing or its general value for other uses than that to which it was applied.

This Court sustained this holding when the case reached it on appeal, *C., B. & Q. R. R. Co.* v. *City of Chicago*, 166 U. S. 226.

There is a test or rule applicable generally to the ascertainment of the "value" of private property alleged to be taken for public use without just compensation. This test is the price that presumptively would be paid for the property in a transaction between a willing buyer and a willing seller, neither of whom is under compulsion to enter into the transaction. There may be no proof available of such an actual transaction but the test is susceptible of rational application to any transaction in-

volving "property" that is really "private" property. The test can not *rationally* be applied to railroad "property" in the process of regulating rates. It is difficult enough to determine the "value" of any public utility which is being physically taken over by eminent domain proceedings or by appraisal under an agreement, and it is settled law that such rules or tests as may apply in such a case do not apply to the determination of "value for rate-making purposes." *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, and cases cited.

It is only by recognizing that "value" as used in railroad rate regulation cases has a special and peculiar significance unknown to economists and described as "fair value" or "value for rate-making purposes" that any hope of a rational determination of the rate base can exist. Even this hope must fade unless the final determination of the rate base or value for rate-making purposes is to rest upon the judgment of an expert Commission (protected by the court from abuse) as to what will constitute "fair" treatment in a broad and just view of wise public policy as between the railroad investor (past and prospective) and the public. Fundamentally this must be the thought underlying the decisions of the court, which has always followed its declarations of the rights of the railroads by equally explicit declarations of the correlative rights of the public.

The opinion of the economists is summarized by Professor James C. Bonbright as follows:

> For many years our courts, following the lead of the United States Supreme Court, have been repeating the doctrine that public utility rates should be so fixed as to allow a reasonable return on the *value* of the property used and useful for the public service. For an equal number of years, however, it has been pointed out by economists that the courts, in accepting this doctrine, are either guilty of a logical fallacy—the fallacy of reasoning in a circle—or else they must mean by "value" something other than commercial or market value. The more one studies the cases, however, the more one is forced to conclude that the courts have not clearly accepted either of these two alternatives, but that their opinions are confusing and inconsistent. This at least has been the conclusion to which a study of decisions on valuation for rate-making has lead most impartial students (p. 494). • • •
>
> In the writer's opinion the use by the courts of the single word "value" to cover such a multitude of different estimates is distinctly unfortunate. It has led to that vicious type of thinking which some people call "conceptualism"— to a confusion of problems that are essentially distinct simply because they are described by terms that have the same spelling and the same sound. If law students and judges would only abandon the attempt to find out what the value is and

> would direct their attention to finding out what the practical problem is, they would avoid much of the disheartening obscurantism that has been so prevalent in valuation studies, notably in the studies of public utility valuation (pages 521 and 522). *The Problem of Judicial Valuation,* by Professor James C. Bonbright, Columbia University Law Review, May, 1927.

Judge C. A. Prouty, late Director of Valuation for the Interstate Commerce Commission, and so long one of its most distinguished members, said in the memorandum (p. 3) prepared by him on the *"Valuation of the Property of the Texas Midland Railroad"* (filed in I. C. C. V. D. 2, Sept. 25, 1917):

> This kind of value was never before John Stuart Mill or Stanley Jevons. The idea had never occurred to John Ruskin when he undertook to draw a sharp distinction between exchange value, which is what a thing will sell for and inherent value, which is what that thing is worth, looking to its possible uses. It is a thing which has come into existence in connection with the regulation of public utilities. It has never been defined by any economist or dictionary maker. It has been described by the courts and is *that sum upon which under all the circumstances and upon a fair consideration of all the facts and elements to be taken into account a fair return should be permitted.* I doubt if any definition can ever add to this description of the thing itself. (Italics ours.)

As the Commission said in deciding the O'Fallon case (p. 29, R. 63):

> The controlling factor in the last analysis is the Supreme Court's conception of what is just and in harmony with a sound public policy. Nor is there any abstract standard of justice that can be applied. The question in many aspects is one of fact, and the answer, if it is to be wise and sound, requires knowledge of actual conditions and a consideration of practical results.

It is doubtless for reasons such as these that the court has persisted in treating "value for rate-making purposes" as something that must be kept indefinite like the "police power," with which railroad regulation is closely related, so that it might be interpreted in the light of changing conditions and broadening conceptions of public policy.

It may be that as so many jurists and economists contend the "fair value" rule is legally and economically unsound. It may be that the various "elements" which the court has said must be given "due consideration" are really so irreconcilable that they can not be applied by any *rational* process to the determination of "fair value." It may be that *either* "prudent investment" or the original cost of construction, plus the amount expended in permanent improvements, *or* the reproduction cost at current prices of labor and materials can arbitrarily be made the controlling "element" or factor, *but* that no two of these can be reconciled or combined and applied by any process of reasoned

judgment. See *Consolidated Gas Co.* v. *Newton*, 267 Fed. 231, 236. Nevertheless, this court has steadfastly resisted every effort to induce it to define "fair value," or *to formulate* any precise method for its determination.

The difficulty largely arises from the failure to recognize that the "fair value" rule of *Smyth* v. *Ames* was never intended to be anything but a *rule of evidence* indicating in the broadest possible terms the various "elements" that were properly to be given consideration by the expert Commission to whose "reasonable judgment" was to be left the final determination of the weight to be attached to each of the many elements entitled to consideration. It is only by this interpretation of the "fair value" rule that any hope of a rational determination of the rate base can exist. Even this hope must fade if the judiciary does not leave to the expert Commission the greatest freedom of judgment in the performance of its legislative function. There is no escape from the fact that "value" as used in railroad rate regulation is not an economic concept but is a "rule of reason" to be applied to one of the most difficult of all the problems of government—the legislative regulation of a private agency engaged in the performance of a "function of government."

**DISTINCTION BETWEEN RAILROADS AND LOCAL PUBLIC UTILITIES**

The distinction between national railroads and local public utilities is real. It may never yet have

been given specific consideration by this Court, but it has been recognized by as eminent authority as Judge Learned Hand in *Consolidated Gas Co.* v. *Newton, supra,* where after making the statement already quoted, that it is "merely an abandonment of any attempt to deal intelligibly with the question to say that cost of reproduction and the original cost are each elements to be considered," he said (pp. 238, 239):

> I am, of course, aware that the present cost of a plant, and especially of a putative standard plant, is hard to prove; but that is no answer. It may in fact be the case, usually it is, that the safest basis for estimate is the evidence of what the actual plant cost, with its additions, which are not renewals, or a cover for renewals. The mere opinions of experts are a doubtful reed; we need not lean upon them; but the question of evidence is one, and of what it shall show is another. *I am aware, also, that in the case of railways the principle of reproduction cost presents most baffling problems, perhaps fatal to its application;* but these arise from the fact that the valuation of a substituted service in the case of railways is impossible, without already presupposing the existence of a railway, so much do railways affect the whole life of the community. In the case of the land used by a gas company, the valuation may theoretically be said to involve a similar begging of the question, for without gas a modern city would be another place.

> Nevertheless, land and building materials and machinery have a value independent of the existence of this or that or any gas company. No "gas value" is involved, as was "railway value" in the ***Minnesota Rate Cases, supra.*** All the component elements are purchaseable, and the cost of the standard plant can be ascertained with fair accuracy. The single element of the cost of tearing up the streets must, however, on authority be omitted. *Des Moines Gas Co.* v. *Des Moines, supra.* (Italics ours.)

In support of the foregoing statement to the effect that "in the case of railways the principle of reproduction cost presents most baffling problems perhaps fatal to its application," Judge Hand cited the able analysis of the authorities and principles by the late Gerard C. Henderson, former General Counsel for the United States War Finance Corporation, in 33 *Harvard Law Review*, 902, 1031.

The regulation of local public utility rates is so different in scale and in character from the regulation of national railroad rates that methods that might be susceptible of some practical application to the former are wholly inapplicable to the latter. This is especially apparent in its bearing upon the practical administration of the recapture provisions of the Transportation Act with its annual computation of excess earnings for all the railroads of the United States engaged in interstate commerce. The fact that the railroads of the United States must be regulated as a whole; that the pur-

pose of their regulation is to "foster and protect and control" them as a whole and that their reproduction as a whole is a pure fantasy differentiates them fundamentally from local utilities. If it be possible to conceive of the reproduction of a municipal water system during a period of "one, two, or three years," and to make some sort of forecast of the prices likely to prevail during such a period as suggested in the *Indianapolis Water Company case*, surely it is utterly fantastic to speculate upon the cost of reproducing the interstate railroads of the United States as a whole, and decades would be required in the process. It would require at least a decade to reproduce any one of the great railroad systems even if it be assumed that all the other railroads are already constructed and functioning during the reconstruction. It is interesting to note that in a brief submitted to the Interstate Commerce Commission by the attorneys of the (Railroad) Presidents' Conference Committee on the Federal Valuation of Railroads, signed, among others, by Mr. Justice Butler, the writer of the opinion in the *Indianapolis Water Company case*, it was said (p. 135):

> We have stated that the ten years preceding June 30, 1914 should be adopted as the period for all railroads because the valuations of some railroads are as of that date ***and because any shorter period will not include a sufficient amount of construction to fairly determine prices.*** (Italics ours.)

If this was true of the decade preceding 1914 what must be said of the decade that followed 1914?

Nor does the court intend, even by such a decision as that in *McCardle* v. *Indianapolis Water Co.* 272 U. S. 400, 71 L. ed. 154, to limit the "fostering guardianship and control" of the Commission over the national railroad system under the broad provisions of the Transportation Act as interpreted in the *Dayton-Goose Creek case*. The *Indianapolis Water Co. case* was clearly decided under its peculiar facts, as we shall undertake to show in our Historical Review of the Law. The inferences which appellants' counsel seek to draw from the language of the opinion written by Mr. Justice Butler are clearly unjustified. He promptly repudiated similar inferences in the railroad taxation case of *Southern Ry. Co.* v. *Kentucky*, 274 U. S. 76.

Surely the court does not intend to declare that a tax commission shall be more free to exercise its judgment in determining "value for taxation" than the Interstate Commerce Commission shall be in determining "value for rate-making purposes," and yet in the recent case of *Southern Ry. Co.* v. *Watts*, 260 U. S. 519, 528, the Supreme Court (citing the *Minnesota Rate Cases*) said:

> The Revaluation Act did not make mandatory any particular method of valuation. The legislature recognized that the difficulties inherent in valuing a railroad are great. It desired that the valuers should have ac-

cess to every fact which might aid them in performing their duty. The data concerning the railroads, referred to in the act, like the methods of valuation referred to in earlier and later legislation, are among those commonly used when an attempt is made to ascertain the value of a railroad. But they are merely aids.

### IMPORTANCE OF FUTURE INVESTMENT AS AN OBJECT AND A TEST

The full significance of the Transportation Act is not grasped unless it is realized that the "new railroad policy" which it inaugurates is to assure for the public an adequate national transportation system by placing railroad finance and railroad securities as definitely as possible on a stable basis. If it is put into effective operation that will be its future effect. It is fundamentally a recognition and acceptance of the great change that is already far advanced by which the real owner of the railroads of the United States is the ordinary investor, looking for the stability of his investment and not for speculation in the changing prices of labor and commodities. It recognizes that the era of the railroad pioneer is over; that the era of consolidation is here; that the way should be kept open for "initiative," but that the need of to-day and of the future is wise executive and financial management, the elimination of unnecessary duplication and waste, and the increase of efficiency and economy. By express statutory provision it is made the function of the Interstate Commerce Commission

to do all that a governmental agency can do to assist in securing these results.

In the *New England Divisions Case, supra,* p. 189, this Court said:

> The 1920 Act sought to insure also adequate transportation service. That such was its purpose Congress did not leave to inference. The new purpose was expressed in unequivocal language. And to attain it new rights, new obligations, new machinery were created. The new provisions took a wide range. Prominent among them are those specially designed to secure *a fair return on capital* devoted to the transportation service. Upon the Commission new powers were conferred and new duties were imposed. (Italics ours.)

It will be noted that the court attaches special significance to the purpose of securing "a fair return *on capital* devoted to the transportation service," and in *Dayton-Goose Creek Ry. Co.* v. *U. S. supra,* at page 481, the court expressed its thought of what would constitute *a fair return on capital* as follows:

> By *investment* in a business dedicated to the public service the owner must recognize that as compared with *investment* in private business he can not expect *either high or speculative dividends,* but that his obligation limits him to only fair or reasonable profit. (Italics ours.)

While this thought of "investment" as the real "private property" entitled to protection is made

clearer than ever by the Transportation Act, it has never been far from the mind of the court. "The original cost of construction" is the first "element" of "fair value" listed in *Smyth* v. *Ames*, and "the amount expended in permanent improvements" is the second. It was justice to those "whose money has been used" to construct and maintain the railroads that was to be secured by the expert commission recommended by the court (p. 527). It was almost immediately after the original pronouncement of the *rule* of "fair value" that the Supreme Court interpreted that very rule as meaning that the railroads were entitled to "a fair return upon the *capital invested.*" In *M. & St. L. R. R. Co.* v. *Minn.*, 186 U. S. 257, 268, decided just four years after *Smyth* v. *Ames*, this Court said:

> Each case must be determined by its own considerations, and while the *rule* stated in *Smyth* v. *Ames* is undoubtedly sound as a general proposition *that the railways are entitled to a fair return upon the capital invested*, it might not justify them in charging an exorbitant mileage in order to pay operating expenses, if the conditions of the country did not permit it. (Italics ours.)

In *Bluefield Waterworks and Improvement Co.* v. *Public Service Commission*, 262 U. S. 679, 692, the court said:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally

being made at the same time and in the same general part of the country on *investments* in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. *The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.* (Italics ours.)

It is of importance to recall that as a part of the legislative history of the Transportation Act, and while it was under consideration by Congress, a member of the Interstate Commerce Commission, in response to a question put to him, publicly informed the Congressional Committee that he knew of no warrant for an assumption "that the Commission will base the value of the property wholly or in part on present prices." The Transportation Act is a recognition by the legislative branch of the Government that the time has come when *invested capital* (past and prospective) shall be given the "due consideration" to which it is entitled in determining the "fair value" that is to be protected in the regulation of rates and the recapture of excess earnings.

Just as the exercise of the "police power" is adjusted to the changing conceptions of the public welfare, so railroad rate regulation must be adjusted to this clearer conception of what is "just" and "fair" and "wise," in the treatment of the "capital invested" and the "property dedicated" to the performance of "a function of the State." Whatever may have been the theory of "fair value," in the past, the Transportation Act has, in and of itself, created new conditions and declared new policies which the court should be prompt to recognize in the interest of the railroads as well as in the interest of the public. If it be a legislative change of public policy it calls for a corresponding readjustment of judicial policy unless there is something unconstitutional in the legislative act. Surely an act of Congress which permits a group return of 6% and which will in fact produce as in the case of the O'Fallon railroad a return of 6% and more on a rate base or valuation in excess of "prudent investment" with provision for the recapture of only one-half of the excess earnings and for the use of the recapture fund *for the benefit of the group* of which the contributing railroad forms a part, can not be held unconstitutional.

It is not contended here that the amount actually or prudently invested in property dedicated to the public service constitutes the sole or controlling measure of value of such property for rate-making or other purposes of regulation; but as indicative

of a growing tendency to give greater weight to "invested capital" than to "current reproduction cost" as the basis for rate regulation, may be cited the Federal Water Power Act, passed by Congress in 1920 (41 Stat. L. 1063), shortly after the passage of the Transportation Act, and the English Electricity Supply Act of 1926 (Chitty's Annual Statutes for 1926, p. 159), and the same principle was applied to taxation in the War Excess Profits Act (40 Stat. L. 300, 302 et seq.), passed by Congress in 1917. The constitutionality of the Act last-mentioned was sustained by this Court in *LaBelle Iron Works* v. *United States*, 256 U. S. 377, and in the opinion of Mr. Justice Pitney (p. 390), special weight was attached to the adoption of

> tests that would enable returns to be more easily checked by examination of records, and make them less liable to inflation than if a more liberal meaning of "capital and surplus" had been adopted; thus avoiding the necessity of employing a special corps of valuation experts to grapple with the many difficult problems that would have ensued had general market values been adopted as the criteria.

It was also said (p. 392):

> Nor can we regard the act—in basing "invested capital" upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment.

Fortunately, also, the opinion in *Smyth* v. *Ames*, contained the wise reservation (p. 547):

> We do not say that there may not be other matters to be regarded in estimating the value of the property,

and in the evolution of legal and economic thought on this vexed subject a test has been suggested by which it can be determined, not whether the method followed by the Commission has been exactly that which would have been followed by the court, but whether a particular "value for rate-making purposes" is sound in law and in economics and in public policy. That test is the one set up by the Supreme Court of Illinois in *Utilities Commission* v. *Springfield Gas and Electric Company*, 291 Ill. 209, 219:

> The real test of the justice and reasonableness of any rate seems to be that it should be as low as possible, and yet sufficient to induce the investment of capital in the business and its continuance therein.

It is the test suggested in *Bluefield Waterworks and Improvement Co.* v. *Public Service Commission*, 262 U. S. 679, 692:

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

The same test is suggested in the summarization of Prof. John E. Kirshman in *The Principle of Competitive Cost in Public Utility Regulation,* 35 Yale Law Journal, 88:

> The economic problem of public utility regulation is largely the problem of meeting competitive wages of labor and management, competitive costs of material and supplies, taxes, and a competitive return to the capital invested.

It is the test suggested in the able article on *Fair Value for Rate Purposes,* by Mr. Robert H. Whitten, 27 Harvard Law Review, 419, 424, (whose *Valuation of Public Service Corporations* is cited with approval in *Des Moines Gas Co.* v. *Des Moines,* 238 U. S. 153, 165):

> The determination of a normal capital cost is one step in the process of determining a normal price, and this normal price is the amount which in the long run it is necessary to pay to secure the utilities demanded by the public. It is the amount which constitutes an adequate inducement for investment.

The procurement of new capital is, indeed, the crux of the whole railroad problem. This has become so much a matter of common knowledge that it is discussed and emphasized in the report of the Commission (and in the dissenting opinion of Commissioner Woodlock) and should be given appropriate recognition by the Court. Its importance is

being pressed upon the general public by eminent railroad authority.

This may be illustrated by the address delivered by Daniel Willard, President of the Baltimore & Ohio Railroad Company, on October 13, 1927, before the Illinois Chamber of Commerce and furnished to the daily press for publication. By way of illustration, and as an important part of the history of the times in relation to this subject, we quote the following extracts from that address:

> Believing, as I do, in the potency of a concrete fact or example, I will illustrate my point by particular reference to the Baltimore & Ohio Railroad, of which Company I have been President for nearly eighteen years. Since I became President of the Company we have spent more than $400,000,000 for additions and betterments to the property, including new equipment, which is at the rate of something more than $23,000,000 each year, and I believe it will be necessary for us to spend annually for some years to come upwards of that same amount.
>
> A very important problem confronting the Baltimore & Ohio Company, therefore, is how is this new capital to be obtained? Obviously we can only obtain it from willing investors, and we will not be able to obtain it from them unless they believe that money invested in Baltimore & Ohio securities will yield at least as good return as could be obtained elsewhere and with just as much security as to principal. In short, we can ob-

tain the new capital needed if our credit is satisfactory, and we can not obtain it otherwise. During the last seventeen years which I have been discussing, all the railroads in the United States, including the Baltimore & Ohio, spent $9,500,000,000, an average of $560,000,000 a year, for additions and betterments, the Baltimore & Ohio capital expenditures being about 4 per cent of the whole. The problem just alluded to, therefore, is one which confronts all of the railroads and not simply the Baltimore & Ohio.

* * * * *

It has been claimed by some that this paragraph from Section 15–a of the Act is equivalent to a definite guarantee of a certain fixed return to the railroads. Of course, it is nothing of the kind nor was it intended to be. On the other hand, there is no use minimizing the real intent of the words I have quoted. They do at least outline a definite policy adopted by Congress for the equally definite purpose of perpetuating the policy of private ownership and operation of the railroads. The members of Congress who voted for the Transportation Act realized clearly that private ownership of the railroads would not be a success and therefore could not continue unless the railroads as a whole were able to raise each year a large sum of money, probably more than half a billion dollars, for necessary additions and betterments, and with that thought in mind the Transportation Act was framed and passed.

The Commission has fixed 5¾% as a fair return within the meaning of the Act, upon the value of the railroad property devoted to transportation purposes, and, for the purpose of establishing a basis for current rates, announced a tentative valuation of the property so used, and while the basis so fixed is below what the railroads generally believe it should be, the roads as a whole have not been able in any year since the passage of the Act, to earn thereon, including subsequent expenditures, the percentage return which the Commission itself has said would be fair, although that result was nearly reached in 1926. In this connection it should, of course, be kept in mind that if from rates as fixed by the Commission any particular railroad should happen to earn in any one year more than 6% upon the value of its property so used, one-half of all earned above 6% must be covered into the United States treasury. This is the price which Congress may be said to have exacted for what has sometimes erroneously been called a guarantee.

In the decision handed down recently by the Commission in the *O'Fallon Valuation Case*, while it was apparent that there was a substantial difference of opinion within the Commission concerning the subject of valuation, it was equally obvious that the whole Commission was in complete accord concerning one very important matter, viz: that under the existing Act they as a Commission were clearly charged with the duty of fixing rates so as to yield a fair return on the value

of the property used for transportation purposes and so make private ownership and operation of the railroads a success if possible, assuming that the roads were efficiently, economically and honestly managed.

I am confident that under the terms of the Transportation Act of 1920 it is possible to so regulate the railroads that the public will receive adequate transportation at reasonable rates as the law requires, and at the same time enable the carriers so regulated to build up and establish a basis of credit sufficient to justify and encourage investors to advance the large amount of new capital required each year for additional equipment, extensions and betterments.

* * * * *

Since January 1st this year more than $100,000,000 of new capital stock has been sold by the steam railroads, not including other issues proposed but not yet consummated. This would seem to indicate a renewed confidence in railway securities, just as Congress expected would result from the passage of the Transportation Act. While no one would claim that the Transportation Act of 1920 is perfect, nevertheless in my opinion it contains the best general plan for the regulation of railroads that has so far been tried in this country and if interpreted and applied as Congress clearly intended it should be, I believe the railroads can be successfully operated thereunder. An imperfect Act well administered is much to be preferred to a constantly changing policy.

> Investors have shown their willingness to purchase railway securities under existing conditions, but any change in the law would disturb, at least temporarily, the confidence of investors and, what is equally bad, if not worse, it would create in the minds of railway managers such a feeling of uncertainty concerning the future that they would hesitate, and rightly so, to undertake large capital expenditures for additions and extensions, even though such additions or extensions might be seriously needed.
>
> The railroads are not asking for anything—at least I am not—except the opportunity to operate under the terms of the existing Act, and given that opportunity they will, I am convinced, furnish the people of this country with adequate transportation at reasonable rates, which is the standard for performance set up by Congress in the Act itself.

The principle is well stated and applied by the Commission in the O'Fallon case (p. 30, R. 64) as follows:

> The end in view, as we have stated, is the maintenance of an adequate national railway transportation system. Such a system, so long as it is privately owned, obviously can not be provided and maintained without a continuous inflow of capital. Obviously, also, such an inflow of capital can only be assured by treatment of capital already invested which will invite and encourage further investment. We think it must be con-

ceded that, under a system of public regulation which produces such a result, private property can not be confiscated. Confiscation is a taking of property without just compensation. It is idle to contend that treatment of private property which attracts and encourages further capital ventures can be confiscatory. Furthermore, public regulation of railroads which is to any considerable degree more liberal to the private owners than is necessary to maintain good credit under reasonably prudent, economical, and efficient management can not be justified. Along with the "fair value" rule this statement in *Smyth* v. *Ames* supra, at page 544, should never be forgotten:

"A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the State. Such a corporation was created for public purposes. It performs a function of the State. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public."

More recently, in *Dayton-Goose Creek Ry. Co.* v. *U. S., supra,* at page 481, this idea was expressed as follows:

"By investment in a business dedicated to the public service the owner must recognize that, as compared with investment in private business, he can not expect either high or speculative dividends but that his obligation limits him to only fair or reasonable profit."

> If such limitations are to be imposed, plainly stability of income and return is a prime requisite. To say nothing of the disastrous effect upon the business and commercial world, violent fluctuations from heights of prosperity to depths of poverty are railroad conditions utterly inconsistent with the necessary attraction of private capital. A corollary of this proposition is that there must be assurance of stability in the rate base. If it is permitted to fluctuate with each change in general price level, and if rates must be adjusted accordingly, there can be no promise of a stable return to investors.

The Commission also said in its report (p. 33, R. 67) that:

> During the period 1920–1926, inclusive, the investment in railroad property increased by 4 billions of dollars. A substantial part of this money was derived from income, but much of it was obtained by the sale of new securities. The market for railroad securities since the passage of the Transportation Act, 1920, has steadily improved and the general trend of interest rates has been downward. The credit of the railroads in general is now excellent, and the time seems to be approaching rapidly when many of them will be able to finance not only through bonds and notes but by issues of new stock. Already some of them are financing their needs in this way. As shown above, investors have not been led to believe, either by our own acts or by the acts of railroad managers,

that rates would be increased in an effort to secure income such as the current cost of reproduction doctrine would demand. Since 1920 the general trend of cost of reproduction new has been downward, but, on the other hand, the trend of the market prices of railroad securities has been very definitely upward. It is a matter of common knowledge that the increase in aggregate market values since 1920 has been very great. With exceptions in certain sections of the country it will be conceded that the railroads are now in better credit and financial condition, in all probability, than at any time in their history. The standard of service is clearly better than ever before. The exceptional situations are receiving consideration with a view to their improvement. The need for improvement in such situations is due not to any deficiency in the aggregate values which we have used as a base in the general rate cases but to failure to earn a fair return upon such values.

REPRODUCTION COST NOT THE CONTROLLING FACTOR

The chief objection made by the petitioners to the valuation in the *O'Fallon case* is that it does not give "due consideration" to reproduction cost, as shown by or reflected in the current prices of labor and materials for and during each of the recapture periods respectively. The contention is that such reproduction cost, which is sometimes called "spot" reproduction cost, is the controlling or predominating or determining factor in ascertaining "value for rate-making purposes." On any sort

of analysis this amounts to the claim that in the absence of some extraordinary exceptional consideration peculiar to the particular case, such "reproduction cost" is the *only* factor and that it is conclusive at least in determing the *minimum* amount that can be used as the rate base.

No decision of this Court has ever so held; and if that result is the necessary deduction from the decisions in which special consideration has been given to reproduction cost, we respectfully insist that the conclusion must be that these decisions have been wrong and should be promptly overruled or modified. We contend, however, that such is not the necessary deduction from the decisions and that the court has not abandoned the rule of *Smyth* v. *Ames*, but still holds that "fair value" is the rate base and therefore the recapture base and is to be found by giving due consideration to a number of elements or factors, and that it is not a matter of formula but rests in the sound judgment of the Commission as to what is "fair" to the public as well as to the railroads. We recognize that the practical application of this method of determining the rate base or "fair value" bristles with difficulties, but it remains "the law of the land," to which reference is made in the specific requirement of the Transportation Act (sec. 15a, 4) that the Commission "shall give due consideration to *all* the elements of value recognized by the law of the land for rate-making purposes."

If the contention is that the rule of *Smyth* v. *Ames* can not be applied because due consideration can not be given to *one* of the elements enumerated in the rule except by making that *one* element controlling, then the "rule" of *Smyth* v. *Ames* is destroyed and the question is what shall be substituted in its place. Certainly nothing has yet been substituted, notwithstanding the decisions in which reproduction cost has been given special consideration under the circumstances of the particular cases in which these decisions were rendered. If something must be substituted, the question is open as to what that substitute should be; and if there is *one* element that should control, it should be "prudent investment" rather than "reproduction cost," varying with the fluctuations of current labor and commodity prices.

The argument for prudent investment is persuasively presented in the separate concurring opinion of Mr. Justice Brandeis in *Southwestern Bell Telephone Company* v. *Public Service Commission*, 262 U. S. 276, and by many economists and students of the subject.

We shall enter into no extended discussion here of the merits of "prudent investment" for use as the rate base, because we believe that the rule of *Smyth* v. *Ames* is still "the law of the land" and that the decision of the commission in the *O'Fallon case* complies with the rule as it was intended to be understood and applied. It also complies with the

Transportation Act as it was intended to be understood and applied. The great advantage of the prudent-investment principle is that it can be *rationally* applied. Like "market value" as between a willing seller and a willing buyer, which is the accepted test of the adequacy of compensation for any other alleged taking of private property for public use, "prudent investment" can be determined by rational processes. It avoids the impossibility of applying to property which is not and can not be made the subject of "exchange" elements which (like reproduction cost) are applicable only to the determination of "value in exchange." In addition, "prudent investment" has the great administrative advantage that once ascertained as of a particular date or for a particular period, it can be revised for any subsequent date or period by merely checking the official accounts and reports made by the railroads to the Interstate Commerce Commission.

Inasmuch, however, as the Commission has not adopted "prudent investment" as the rate base or "value for rate-making purposes" in the *O'Fallon case* (although it has pointed out some of its advantages) but has adopted a higher valuation than either original cost or prudent investment, we ask the consideration of the court to the many objections to the use of "reproduction cost" as the sole or determining factor for this purpose.

Such a use of reproduction cost is unsound legally and economically. It is enormously and wastefully

expensive. It depends almost entirely upon the use of "that most unsatisfactory evidence, the testimony of expert witnesses employed by the parties." (*City of Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1.) It practically necessitates a vast array of real estate, engineering, and accounting experts, both by the railroads and by the commissions, to engage in protracted hearings before the commissions and the courts as to values and changes in values, upon which opinion may and does differ to an extraordinary extent. These opinions are exceedingly difficult to check in their application to a complicated plant or property, such as a railroad, which is normally the product of growth and development over a considerable period of time, and by a process which bears no possible resemblance to "reproduction." (See the able discussion in *Fair Value of Public Utilities*, by Prof. Edwin C. Goddard, 22 Michigan Law Review, 652 *et seq.* and 777 *et seq.*) In his *Fair Value for Rate Purposes*, 27 Harvard Law Review, 419, 424, from which we have already quoted, Mr. Robert H. Whitten says:

> If railroads were in fact entirely reconstructed each year there would be reason in this method of cost determination. But they are not, and can not be constructed and operated on any such theory. The real cost of transportation can only be determined by recognizing the only process by which transportation service can be supplied—that is,

by devoting capital permanently to the enterprise.

The value of a secondhand automobile (selected in appellants' brief, p. 65, as an apt illustration) is not "largely, if not primarily determined by the cost new at the time of a similar vehicle, with appropriate deduction for prior use and accrued depreciation"; and the application of secondhand prices to railroad equipment, as suggested in appellant's brief (p. 66) would not "approach, if not equal, its depreciated value on the basis of current prices if new." If the determination of the value of a used automobile is "controlled" by an estimate of its then reproduction cost, less depreciation, could its reproduction cost at any given time be determined by ascertaining the then prices of material and labor and applying index figures to the costs of material and labor when it was originally constructed? Would such methods ever be applied in the valuation of the property of a concern using large numbers of automobiles? Is not the automobile industry, with its remarkable decreases in market prices of automobiles in the face of large increases in labor and material prices, a conspicuous example of the fallacy of appellants' whole contention?

**The reproduction-cost theory particularly inapplicable to annual valuations of railroads under the Transportation Act**

The reproduction cost rule is itself vague and uncertain. It is not of scientific origin, and no sci-

entific or economic exposition or defense of it as applied to railroads has ever been stated by any court. There is no presumption that the "value" of any property is what it would cost to reproduce it; certainly not what it would cost to reproduce it at any particular time or during any particular year.

To apply to railroads the factor or "element" of reproduction cost with any logical consistency, it must be imagined that the railroad is not already there and, indeed, that it never has been there, and the estimate must be what it would cost *under this assumption* to put it there. This, however, is never the assumption under which reproduction cost is estimated, and it is inconceivable that the court would tolerate the purely fanciful and enormous valuation that would result under this assumption, especially if the assumption must be made for the railroads of the United States as a whole, which is what the Transportation Act necessitates. Shall the Commission assume in valuing each individual railroad that all the other railroads are there, or that none of them are there or that the historical facts of actual railroad construction shall be reproduced in each instance?

In the *Minnesota Rate Cases supra*, the whole reproduction cost theory was rejected as inherently inapplicable to railroad rights of way and lands, and the writer of the opinion in that case (Mr. Justice Hughes) later rejected it as inapplicable to public utility structures and equipment, when he

was faced with the actual responsibility of determining the rate base or "value for rate-making purposes" as arbitrator in the *Brooklyn Borough Gas Case supra.* The searching analysis contained in the opinion in the *Minnesota Rate Cases* exposed the fallacy of assuming that an agency of government exercising in the public welfare the power of eminent domain should be capitalized for rate-making purposes as though it were being reproduced *de novo* through the territory whose development (and subsequent increase of "exchange" value) was the sole justification for delegating the extraordinary governmental powers, to the exercise of which the railroad owes its very existence.

The method of valuing railroad land actually adopted in the *Minnesota Rate Cases* was a compromise resting upon nothing but the court's unformulated sense of "fairness." The fact that the court was unable to formulate the basis of its compromise of the conflicting public and private interests no doubt accounts for its declaration that determining value for rate-making purposes "is not a matter of formulas; but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts." And when the writer of that declaration came to consider the valuation of structures and equipment for rate-making purposes, he not only rejected the method of "spot" reproduction cost, but in the exercise of "a reasonable judgment" he adopted the method which has been applied in the *O'Fallon Case.*

An obvious limitation arises at the very threshold of the application of current reproduction cost to the determination of "value." This is the necessity of showing that a prudent investor in the exercise of sound business judgment would, in fact, reproduce the railroad where it is and as it is and *at the current cost of reproduction.* In *U. S.* v. *Boston, Cape Cod & N. Y. Canal Co.,* 271 Fed. 877, 889, the court was confronted with the question whether estimates of the cost of reproduction of the canal should be received in evidence at all "in the absence of proof that a reasonably prudent man would purchase the property or undertake its construction at reproduction prices," and the court said:

> It seems to us that this is a necessary limitation upon the application or use of the rule when construction prices are abnormal, and that the court below either should have passed upon the preliminary question of fact himself or submitted it to the jury with instructions that they should not consider the evidence of reconstruction cost upon the question of value unless they were satisfied that a reasonably prudent man would purchase or undertake the construction of the property at such a figure.

The fact that there has been so little new railroad construction or extension since 1914, and especially since 1919, is prima facie proof that "construction prices are abnormal" and that it is not regarded as sound business judgment to construct

new railroads at the prevailing prices of labor and materials.

From the provisions of the Transportation Act already quoted it seems clearly apparent that while there is to be appropriate revision of the valuation of individual roads, and hence of all the roads, both for the purpose of rate-making and of recapture, the Act intends to give to the final valuation under Sec. 19a a certain *prima facie* stability, free, at least, from an annually recurrent revision to correspond with the fluctuating prices of labor and material. This interpretation of the Transportation Act is strengthened by an examination of the provisions of Section 19a, Paragraph (f) which reads:

> Upon the completion of the valuation herein provided for the Commission shall thereafter in like manner keep itself informed of all extensions and improvements or other changes in the condition and value of the property of all common carriers, and shall ascertain the value thereof, and shall, from time to time, revise and correct its valuations, showing such revision and correction classified and as a whole and separately, etc.

The words "in like manner" have always troubled the Commission in its consideration of future procedure under the Valuation Act, because the original valuation requires detailed inventories and estimates of the railroad properties, but the very impracticability and indeed absurdity of re-

quiring the Commission to reinventory in detail the physical properties of all the railroads annually so that it may "keep itself informed" not only of all extensions and improvements but also of "other changes in the condition and value of the property of all common carriers" simply because there would be "changes" in the "value" of some of the items of labor and materials inventoried *if the property was being currently reproduced,* would seem to exclude the posibility of such a construction of the statute. The very next paragraph, (g), provides:

> To enable the Commission to make such changes and corrections in its valuations of each class of property, every common carrier subject to the provisions of this Act shall make such reports and furnish such information as the Commission may require.

It would, therefore, seem that the only reasonable interpretation of the Act is that when the original valuation is completed the Commission shall thereafter keep itself informed of extensions, improvements, and other like changes in the condition and value of the property by requiring and checking appropriate reports and other information from the carriers. These reports would furnish information "in like manner," as to inventory details, as the manner followed by the Commission in making its first completed valuation. It is to be noted that the only thing that is to be done "in like manner" is for the Commission to "keep itself in-

formed." It is not required that the Commission "shall *in like manner* ascertain the value" or shall *in like manner* from time to time revise and correct its valuations. The words "in like manner" apply only to the acquiring of information. Section 19a and Section 15a are both parts of the Interstate Commerce Act and they are to be construed together and in such a way, if the language will admit, as to make the entire act practically workable. This is not possible if the "value for rate-making purposes" of all the railroads of the United States is to be annually revised by inventories in detail simply for the purpose of readjusting the inventory prices to correspond with current prices of labor and materials. The method adopted in the *O'Fallon case* is the only method that is practically workable.

Even in the case of property devoted to competitive commercial business and subject to barter and sale, its "value" would not be indicated by the cost of reproducing that identical property, although the cost of producing a property capable of rendering an equivalent service might constitute some evidence of "value."

Yet it is wholly impracticable to determine this in the process of valuing the railroads of the United States. As a matter of practical administration the Commission would be compelled to accept the existing railroads as they are and as a whole. It would be fantastic to take the existing railroad structure apart even theoretically for the

purpose of determining whether and to what extent some one railroad would be better located or better constructed and equipped to furnish an equivalent or superior service; and yet to value it at its reproduction cost as it is, means to accept all of the past mistakes or failures in foresight. The total net result of valuing each railroad at its "spot" or current reproduction cost would be to fasten on the public a rate base including vast sums representing unnecessary or uneconomic duplications of tracks, terminals and other facilities and equipment. To inquire whether a better national railroad system—one that could render a better service at less cost—than the existing system, could and would be built if we were "reproducing" our railroads, and just what and where located that better systems would be is wholly impracticable. It is impracticable to conduct such an inquiry with respect to any one railroad incorporated as it is in the national system as a whole and dependent upon it as is the territory it serves, its business and its people. As Judge Learned Hand said in *Consolidated Gas Co.* v. *Newton, supra* (p. 238):

> I am aware, also, that in the case of railways the principle of reproduction cost presents most baffling problems, *perhaps fatal to its application*; but these arise from the fact that the valuation of a substituted service in the case of railways is impossible without already presupposing the existence of a railway, so much do railways affect the whole life of the community. (Italics ours.)

Presumptions from "spot" reproduction cost are particularly inapplicable to the railroad systems of the United States. Railroads are not produced in a year or in any small number of years. As a general rule of practically universal application, railroads are produced during many years by a process of growth in which constant additions and improvements are made. New parts are added and old parts are replaced with new parts of all sorts of merit and demerit and at all sorts of prices. The construction and equipment is of all sorts, ages, and conditions.

The Commission well says (Report p. 36, R. 70):

> The structures of a railroad system may be compared to a great river like the Mississippi, in which the main stream represents lines of railroad in the system and the branches represent the perpetual flow of new material into it. At New Orleans the Mississippi River is a composite of a vast multitude of waters contributed by a corresponding number of tributaries, big and little. Similarly, at any moment a railroad system is the result of contributions made by many different streams of materials, some wearing out rapidly and others slowly, but all requiring replacements from time to time. All are indispensable to keep the main stream efficient for service. Unless these collateral streams of materials maintain an uninterrupted flow into the railroad structure, the railroad system deteriorates and service to the public suffers. Each kind of material

> is acquired at prices prevailing when the purchases are made, either at the time of installation or prior thereto, when materials are drawn from accumulated stores, and during periods of time varying by days, months, and years. Just as the water of the Mississippi at New Orleans is composed of waters from myriads of different sources, so a railroad system is a composite of materials acquired at myriads of different prices and at infinitely varying periods of time, and put into the plant at many different levels of wages. Neither the highest price nor the lowest, nor the average, nor any price in between, represents the outlay made for the system. The only thing that does and can represent what the investor has contributed to the value of the property is the aggregate amount which was paid for the many different items in the perpetual stream of metamorphosing railroad structures.

In determining "value for rate-making purposes," it must also be kept in mind that the cost of much of this process is paid for out of the rates paid by the public. The cost of much of the labor and materials is charged to operation. In the very nature of the process it is inherent that a considerable improvement and increase in value, if measured by reproduction cost, represents no additional investment or capital expenditure. It is strenuously urged by the railroads that provision should be made in the rates themselves for securing precisely this result, and statutory recognition of the

propriety of this claim was given when the Transportation Act, Sec. 15a (3), provided that in determining from time to time what percentages of aggregate property value will constitute a fair return thereon to be paid for out of rates, the Commission—

"shall give due consideration, among other things, to the transportation needs of the country and the necessity (under honest, efficient, and economical management of existing transportation facilities) of *enlarging such facilities*, in order to provide the people of the United States with adequate transportation; and Provided, That during the two years beginning March 1, 1920, the Commission shall take as such fair return a sum equal to 5½ per centum of such aggregate value, *but may, in its discretion, add thereto a sum not exceeding ½ of 1 per centum of such aggregate value to make provision in whole or in part for improvements, betterments, or equipment, which, according to the accounting system prescribed by the Commission, are chargeable to capital account.*"

It should require no argument to show that such a principle is utterly inconsistent with the use of reproduction cost to determine the rate base. The injustice of requiring the public to pay rates based on contributions which the public itself has made for the express purpose of improving the railroads and relieving them of making capital expenditures is at once apparent.

Irrespective of these provisions of the Transportation Act, the practical development of the railroad system of the country has always involved substantially the same result. Rights of way are improved in the process of maintenance and repair. New and better rails are substituted. Improved equipment replaces the old without any new investment or specific additions to capital account. This can not be avoided, and in the public interest there should be no attempt to avoid it. Maintenance and repairs should not be too closely restricted, provided the public is not compelled to pay increased rates because of the very expenditures it covers in the rates in order to improve the facilities of transportation.

Past accounting can not be generally revised. Lost records and accounts can not be replaced. But some fair approximation can be made to determine the value or rate base as of some period or date, and that value or rate base can be revised by adding the cost of the capital additions and subtracting the cost of the capital retirements. This is the only rational way to assure fair treatment of the railroads and of the public under an enlightened transportation policy for the future. It is the process followed by former Justice Hughes in the *Brooklyn Borough Gas Case, supra.*

It may be seriously questioned whether it lies within the power of the court to make reproduction cost the sole or the controlling element in determin-

ing value for rate-making purposes. The regulation of rates is a legislative and not a judicial function. It is only to prevent confiscation or abuse that the court can interfere, and it is only for this purpose that it should desire to interfere. When Congress declares, as it has in the Transportation Act, that the Commission can consider *all* elements, the court can not say that it shall consider only *one* element or give to that one element controlling weight. There is really no way of giving it the weight which railroad counsel claim for it except to make it the *only* element. Even if the court has the power to so declare, it has manifested no disposition to exercise such a power. On the contrary, it has sought to avoid commitment to any rule or formula.

While the tendency of some recent decisions may seem to confine the exercise of judgment or discretion by the Commission within exceedingly narrow limits, other decisions indicate that the court intends no such inferences from what it says as to the use of reproduction cost.

In the case of *Willcox* v. *Consolidated Gas Company*, 212 U. S. 19, 52, this Court said:

> If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase. This is, at any rate, the general rule. *We do not say there may not possibly be an exception to it where the property may have increased so enormously in value*

> ***as to render a rate permitting a reasonable return upon such increased value unjust to the public.*** How such facts should be treated is not a question now before us, as this case does not present it. We refer to the matter only for the purpose of stating that the decision herein does not prevent an inquiry into the question when, if ever, it should be necessarily presented. (Italics ours.)

The Commission is now faced with the very situation the possibility of which was thus foreseen. As a result of the World War the current prices of labor and materials in general have been subject not only to abnormal increases but also to extraordinary fluctuations, estimated by the Commission (if it were to accept some of the testimony in the *O'Fallon case* applicable to the years 1919 to 1923, inclusive) as varying from 41.4 billions of dollars in 1920 to 35.1 billions in 1921, 28.3 billions in 1922, and 31.3 billions in 1923, or in the language of the Commission (p. 32, R. 66):

> In other words, assuming a static property, there would have been a gain of 23.4 billions in 1920, a loss of 6.3 billions in 1921, a further loss of 6.8 billions in 1922, and a gain again of 3 billions in 1923. These huge "profits" and "losses" would have occurred without change in the railroad property used in the public service other than the theoretical and speculative change derived from a shifting of general price levels. To put it still more graphically, by the application of

> the current reproduction cost doctrine the assumed base of 18 billions would have been increased in 1920 by a sum greater than the present national debt (about 19 billions), and the transportation burden upon the people of the country would have been correspondingly increased without the investment of a single dollar by those who would reap the benefits.

What is to be the measure of abatement from current reproduction cost when current price levels have "enormously" increased? Is it to be the chancellor's foot or the "judgment" of the Commission? How can reproduction cost be a serviceable guide to court or commission when it must be subject to such reservations as this? *Except as a possible aid to the Commission in forming its judgment as to what, in the language just quoted from the Willcox Case, is "unjust to the public" and subject to some such test as that suggested in the Springfield Gas Case, how can the determination of the weight to be attributed to reproduction cost rest upon anything but temperament and caprice?*

How is the Commission to find a basis for the exercise of rational "judgment" (as to the weight to be attributed to reproduction cost at current price levels) when it is told in the *Indianapolis Water Co.* opinion, that the "fair value" rule of *Smyth* v. *Ames* "does not mean that the original cost or the present cost or some figure arbitrarily chosen between these two, is to be taken as the measure," but that "the weight to be given to such

cost figures *and other items or classes of evidence is to be determined in the light of the facts of the case in hand," and when the actual decision in that case adopts a valuation far below "spot" reproduction cost, presumably because enlightened self-interest had led the Water Company to ask for no more.* A few months after Mr. Justice Butler wrote that opinion, he wrote the opinion in *Southern Ry. Co.* v. *Kentucky*, 274 U. S. 79, 81, in which he said:

> The value of the physical elements of a railroad—whether that value be deemed actual cost, cost of reproduction new, cost of reproduction less depreciation, or some other figure—is not the sole measure of, or guide to, its value in operation (*Smyth* v. *Ames*, 169 U. S. 466, 547). Much weight is to be given to present and prospective earning capacity at rates that are reasonable, having regard to traffic available and competition and other conditions prevailing in the territory served.

It is true that this was a taxation case, but the authority cited is *Smyth* v. *Ames*, a rate case. When the Commission reaches the Southern Railway in its recapture work is it to value its property at current reproduction costs, and is that to be its "value for rate-making purposes"? Are its competitors to be similarly valued? Are the rates to be fixed on the sum of these values? Is the existing competition to be considered in diminution of the

"value for rate-making purposes" of any of them or of only some of them, and of which of them? How shall it be measured and apportioned?

The assumption in the opinion in the *Southern Railway case* is that *at the existing rates* the competition reduces the net earnings below a fair return on reproduction cost. In order to avoid "confiscation" must the rates be increased so that this will no longer be true—provided only that the traffic will bear the increase? Is the discarded test of "what the traffic will bear" the only limit (except the voluntary self-restraint of the railroads themselves) to the increase in rates (based on reproduction cost) to which all of these competitive railroads are constitutionally entitled? How is the Commission to determine "what the traffic will bear" except by estimating what the shipper would and could pay rather than not have his shipments transported? If the Commission is of the opinion that there is too much railroad competition in a particular territory, how will it measure the extent to which, and how shall it determine the manner in which this should be calculated in diminution of reproduction cost in fixing the recapture base? We do not expect the court to answer these questions directly in this case, but the answer of the court in this case should be made with "due consideration" of these and many other "elements" in the difficult issues that the Commission (and the Court) can not evade.

"Prudent investment" may be a "formula" which the Commission is not slavishly to follow, but "prudent investment" furnishes a far more intelligent, logical, and practically workable test than "spot" reproduction costs or readjustments to fluctuations in the purchasing power of the dollar. The present purchasing power of the dollar is due to world-wide conditions and is involved in a process of economic readjustment still in progress far from complete and from the effects of which the capital stocks of railroad corporations are not entitled to a special and peculiar legalized exemption. Interest and dividends are still paid in what are called "depreciated dollars" and have not fluctuated in any measurable relation to the fluctuating price of commodities and labor. The beneficiaries under the outstanding insurance policies in this country will all be paid in the dollars current on their respective dates of payment. Competitive business seeks to mark up its "capital value" as a means of adjustment to the increased cost of operation. Railroads are "competitive" only in a very limited degree. They are essentially monopolistic and their rates are increased by the Commission for the very purpose of meeting increased costs of operation, while their bond interest is still paid in depreciated dollars.

There is not the slightest evidence that returns to capital or property invested in competitive busi-

ness vary in any recognizable relation to fluctuations in the purchasing value of the dollar. Conservative business concerns *sometimes* increase the inventory valuations at which their land and other capital assets are carried on their books so that these valuations may correspond with apparently permanent changes in the market values of such assets, but conservative enterprises never readjust their capital values to correspond with fluctuating commodity prices during any year or small period of years. Even if they did their profits would not correspond with such readjustments. It may be wise public policy to stabilize railroad returns and railroad credit so as to reward past and invite future investment; but why should the railroads be given, in addition to this, profits that are not ordinarily made even in competitive business? They can not fairly be protected from the risks of competition and at the same time be given the profits sometimes gained in competition. In the language of the *Dayton-Goose Creek case supra*, p. 481, already quoted:

> By investment in a business dedicated to the public service the owner must recognize that as compared with investment in private business he can not expect either high or speculative dividends but that his obligation limits him to only fair or reasonable profit.

The most active and distinguished advocate of the stabilization of the dollar by adjusting it to fluctuating commodity prices is Professor Irving Fisher

of Yale University. Even he can not accept the logical application of the reproduction cost theory to the problem of railroad valuation. In a copyrighted article entitled *"Rail Valuation Still a Problem. Question of Fair Return to Owners Yet to be Adjudicated"* (Chicago Journal of Commerce, June 27, 1927), he says, in part:

> • • • This would be the simple rule if there were no bondholders. But there are bondholders, and there is the public.
>
> The majority of the Interstate Commerce Commission very properly pointed out that railway bonds constitute nearly two-thirds of the investment in public carriers, and these are limited to a fixed return on the number of dollars originally invested. The investor who has bought bonds and so contracted to receive this fixed return in dollars is manifestly permitted to receive no more. If the dollar depreciates in value, he loses; the unstable dollar has picked his pockets, and he can quite properly denounce this impersonal pickpocket; it is not his fault that he is robbed. But he has made his bed, and he must lie in it. He has made a contract and can not modify it or have it modified in his behalf by the Interstate Commerce Commission.

### *Lose by Terms of Railroad Bonds*

Thus the bondholders simply have to lose by the terms of the railroad bonds. That is a fact which has to be faced. In so far as they lose, some one else gains. If rates are naively

adjusted, in proportion to the price level, the gainer will be the stockholder. This is what happens in the case of an ordinary commercial concern.

But in the case of a public utility no such gain should go to the stockholder. The only party to whom it can and should go is the public. In the case of a public utility the public interest is paramount.

The principles, then, are: (1) The bondholders lose because they can not get an increased valuation of their share in the railroad properties; (2) the stockholders are not entitled to profit by the bondholders' loss; (3) therefore it should accrue as a gain to the public.

How shall we apply these principles? The fair method would be to make not merely one correction in property valuation and rate, but, as it were, two corrections simultaneously.

### *Requires Rate Adjustment*

The first correction requires that the rates shall be adjusted upward in exact proportion to the rise in the price level. This is the simple rule stated above and incorporates the viewpoint of the dissenting minority of the commission. But this correction is in turn subject to a recorrecton by which the rate should be readjusted downward to avoid giving the stockholder more than his share. The correction as first made does give the stockholder more than his share by the amount of the bondholders' loss. This amount can

easily be computed. It is the bondholder's annual interest in dollars multiplied by the loss in purchasing power of the dollar. Therefore the rates should be so reduced as to reduce the stockholders' income by that amount.

These two corrections could be made in one step, by "weighting" the change in the price level according to the ratio of stocks to bonds in the capital structure at the base period.

This is, indeed, "naive". It aptly illustrates the sacrifices of principle that must be made in the attempt to apply a novel economic theory to the stubborn realities of a situation to which the theory has no rational application. It is necessary to sacrifice the principle in the effort to save it. The rates are first to be adjusted up and then to be adjusted down by combining both operations through a process of "weighting the change in the price level." And all this for the purpose of making the railroad stockholder a privileged investor, although not so highly privileged as he would be if the reproduction-cost theory was fully applied to the determination of the *rate base* instead of being partially (33⅓%) applied to the *rates*. The reason given is that "in the case of a public utility the public interest is paramount." As Professor Fisher says, "*there is*, indeed, *the public*," to whose service the stockholder's investment was dedicated. Until the fluctuating commodity-price dollar becomes the legal medium of exchange, what possible justification is

there for making the railroad stockholder a privileged investor? Will it be in the public interest to tell the investor in new railroad stocks and bonds that if the commodity-price index goes down he will be paid fewer dollars because at the moment they will purchase more commodities? In a world of realities will this promote future investment in railroad securities?

Professor Fisher's statement that "the public interest is *paramount*" may seem to some a little sweeping. It is not "unfair" to note that increases in "value" based on reproduction cost carry no implication that there has been a corresponding increase—or indeed any increase—in service or facilities for service, while increases in value due to additional investment do imply just this and are justified by this.

**HISTORICAL REVIEW OF THE DECISIONS OF THE SUPREME COURT, SHOWING THAT THE COMMISSION FOLLOWED THESE DECISIONS, TAKEN AS A WHOLE, IN DETERMINING VALUE IN THIS CASE**

The decisions of this court that have an important bearing in one way or another upon the principles affecting the recapture base or "value for rate-making purposes" are too numerous to justify or require a complete review. We ask the indulgence of the Court, however, while we recall to its attention the more important of its own decisions by which "the law of the land" has been developed to the stage at which we now find it.

If appellants' contention is sound that the Transportation Act of 1920 was passed in contemplation of the "law of the land" as *then* declared by this Court, this assumption can not be applied to subsequent decisions, but our review extends to and includes the *Indianapolis Water Co Case*. We do not include damage cases such as *Standard Oil Co. v. Southern Pacific*, 268 U. S. 146, cited by appellants.

In considering these decisions it is of first importance to recall and to keep in mind the background upon which that law has been developed, and particularly the contentions of the opposing parties and the circumstances under which these contentions have arisen and have been maintained, as well as the principal arguments or lines of reasoning by which it has been attempted to maintain them. In our quotations the italics are ours.

In the very beginning of railroad construction in this country the railroads asserted and successfully maintained their right to exercise under grant from the Legislature, the power of eminent domain, which is the power to take the property of the individual citizen for public use against his will upon payment of money compensation, the amount of which is determined by its commercial value without regard to any special considerations of attachment or purpose which may make the particular owner especially reluctant to part with his property (*pretium affectionis*). This is probably the most extreme and arbitrary power of Govern-

ment except conscription or taxation. Its delegation to a railroad corporation, as well as the levying of taxes and the making of gifts or grants in aid of the railroads, was sustained in the courts, solely and expressly upon the ground that the railroad corporation was an agency of the Government, created to perform a function of the State.

The railroad law of this country is built upon that foundation. The numerous decisions to this effect are sufficiently illustrated by *Talcott* v. *Pine Grove*, 23 Fed. Cases 652, affirmed in 86 U. S. (19 Wall.), 666 (1873), from which we have already quoted. The language of *Redfield on Railways* was adopted by the Supreme Court in the case above cited (p. 678):

> Though the corporation was private, its work was public, as much so as if it were to be constructed by the State.

The abuse of their powers by the railroads led to the enactment by various State Legislatures of laws placing maximum limits upon the rates of fare and freight, and the railroads attacked the validity of these laws upon the ground that they were private, although highly privileged, corporations exempt from governmental regulation. When the question came before the courts for determination, the railroads sought to ignore the principles (and obligations) upon which their very existence depended, and, strangely enough, these principles and obligations do not appear to have been called to the attention of this court and are not mentioned in its

early decisions which rejected the contention of the railroads. The probable explanation for this lies in the fact that the leading case in the series of "Granger Cases" was *Munn* v. *Illinois*, 94 U. S. 113 (1877), which was a warehouse case and not a railroad case; and while it was followed in the same group by cases involving statutes fixing maximum rates for railroads, the attention of the court was first concentrated upon the statutes regulating the charges and practices of public warehouses engaged in the storage and handling of grain. The validity of these warehousing statutes was sustained in the epoch-making decision (opinion by Chief Justice Waite) in *Munn* v. *Illinois, supra*, as an exercise of the "police powers."

It was not until the decision in *C., M. & St. P. Ry. Co.* v. *Minn.*, 134 U. S. 418, in 1890, thirteen years later, that, as we shall see, the "governmental" character of a railroad was recalled to the attention of the court in the dissenting opinion of Mr. Justice Bradley, with whom Mr. Justice Gray and Mr. Justice Lamar concurred. It was, thereafter, clearly recognized and reasserted in the majority opinion in *Smyth* v. *Ames, supra*, and has been reaffirmed in numerous subsequent opinions, including *Dayton-Goose Creek Ry. Co.* v. *U. S., supra*. It is respectfully suggested that a recurrence to this fundamental doctrine as laid down in *Talcott* v. *Pine Grove, supra*, would have avoided most of the errors and uncertainties of the law, as this

Court has endeavored to find some other principle upon which the conflict of public and private interests can be rationally adjusted.

Reverting to the *Granger Cases*, it is to be noted that in *Munn* v. *Illinois, supra*, the court said, with respect to the regulation of warehouse rates:

> We know that this is a power which may be abused; but that is not argument against its existence. For protection against abuses by Legislatures the people must resort to the polls, not to the courts (pp. 133–134).

The immediately following case of *C. B. & Q. R. R. Co.* v. *Iowa*, 94 U. S. 155, 161, 162, reiterated the doctrine just quoted.

And in *Peik* v. *C. & N. W. Ry. Co.*, 94 U. S. 164 (the next of the *Granger Cases*), the court again indicated that there was no judicial review of legislative rate making.

The court, however, subsequently withdrew this extreme assertion of legislative power. In *The Railroad Commission Cases*, 116 U. S. 307 (1886), the court, apparently persuaded by the vigorous dissent of Mr. Justice Harlan, inserted in the majority opinion the following disclaimer to its reassertion of the doctrine of the *Granger Cases* with respect to legislative power:

> From what has thus been said it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy and limitation is not the equivalent of confisca-

> tion. Under pretense of regulating fares and freights, the State can not require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation or without due process of law. What would have this effect we need not now say because no tariff has yet been fixed by the Commission, and the statute of Mississippi expressly provides "that in all trials of cases brought for a violation of any tariff of charges, as fixed by the commission, it may be shown in defense that such tariff so fixed is unjust."

From the dissenting opinion of Mr. Justice Harlan, it appears that the concept of "value" was for the first time injected into the consideration of this subject by the Mississippi statute of 1884, which authorized the State Commission to so revise the railroad tariffs "as to allow a fair and just return on the *value* of such railroad, its appurtenances, and equipment" and to increase or reduce the rates so established "as justice to the public and each of said railroad companies may require," and "as experience and business operations may show to be just." The legal and economic confusion involved in this statutory "counsel of perfection" was promptly seized upon in Mr. Justice Harlan's dissenting opinion, and it is, therefore, all the more surprising that he himself perpetuated it when he came to write the majority opinion in *Smyth* v. *Ames, supra*. In *The Railroad Commission Cases,*

the issue, apparently, was merely as to where the *burden of proof* would lie and whether it would relate to the "reasonableness" of the rates or the "reasonableness" of the legislative regulation of the rates. The interesting part of Justice Harlan's opinion, however, is that in which he says:

> Would they (the railroads) have risked the immense sums *invested* in these enterprises had the charters of the companies contained a provision making rates to depend, not on the capabilities, wants, and interests of the territory to be supplied with railroad service, *or on the amount expended in constructing and maintaining these roads*, but on their *value* as estimated by commissioners, and on such basis as the latter, from time to time, might deem to be justified by experience and business operations? Their value, upon what basis, or at what period of their existence? When they were constructed? Or what they would bring at a sale under a decree of court?

Two years later, in *Dow* v. *Beidelman*, 125 U. S. 680 (1887), this Court was happily unanimous in holding that a legislative rate tariff of 3¢ per mile, which would produce less than 1½% on the original cost of the road and only a little more than 2% of the amount of the bonded debt of the company, would not be held invalid by the court where there was no evidence whatever "as to how much money the bonds actually cost, or as to the amount of the capital stock of the corporation as reorgan-

ized, or as to the sum paid for the road by that corporation or its trustees" (p. 690).

The real issue was first squarely raised and decided by a much-divided court in *C. M. & St. P. Ry. Co.* v. *Minn.*, 134 U. S. 418 (1890), which involved a State statute not merely authorizing the State Commission to fix rates, but providing that the rates so fixed should be final and conclusive. This assertion of arbitrary legislative power was rejected by the court on the following ground:

> It deprives the Company of its right to a judicial investigation by due process of law under the forms and with the machinery provided by the wisdom of successive ages for the investigation judicially of the truth of a matter in controversy, and substitutes therefor, as an absolute finality, the action of a Railroad Commisison, which, in view of the powers conceded to it by the state court, can not be regarded as clothed with judicial functions or possessing the machinery of a court of justice (p. 457).
>
> * * * * *
>
> The question of the reasonableness of a rate of charge for transportation by a railroad company involving, as it does, the element of reasonableness both as regards the company and as regards the public is eminently a question for judicial investigation requiring due process of law for its determination. If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation

> takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law and in violation of the Constitution of the United States; and in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their *invested capital*, the company is deprived of the equal protection of the laws.

This decision has subsequently been modified to make clear that railroad regulation may be properly entrusted to an expert commission "appointed by law and informed by experience," whose findings will be respected and sustained by the court unless it clearly appears to amount to "confiscation" or to have been reached by a process amounting to the denial of "due process of law" or to "the taking of private property for public use without just compensation."

The burden of proof rests upon those attacking the reasonableness of the regulation. This is now settled law. *Willcox* v. *Consolidated Gas Co.*, *supra*, and cases cited. The arbitrary power of the Legislature, subject only to political redress, has, however, ceased to be free from judicial review. This result was not accomplished without a vigorous dissent from Mr. Justice Bradley, with whom concurred Mr. Justice Gray and Mr. Justice Lamar, who pointed out that *Munn* v. *Illinois* and the other *Granger Cases* were being overruled.

The dissenting opinion concedes that there may be a judicial review for arbitrary action on the part of the Legislature or fraud on the part of the commission, but it asserts that these are the only grounds on which judicial relief may be sought, and concludes:

> There was, in truth, no deprivation of property in these cases at all. There was merely a regulation as to the enjoyment of property, made by a strictly competent authority, in a matter entirely within its jurisdiction.

Four years later, in *Reagan* v. *Farmers Loan & Trust Co.*, 154 U. S. 362 (1894), the court sustained the Texas statute creating the State Railroad Commission, and held that, "If the rates established by the commission are not conclusive they are at least *prima facie* evidence of what is reasonable and just," and said (p. 412):

> It is unnecessary to decide, and we do not wish to be understood as laying down as an absolute rule that in every case a failure to produce some profit to those who have *invested their money* in the building of a road is conclusive that the tariff is unjust and unreasonable. And yet justice demands that everyone should receive some compensation for the use of his money or property, if it be possible without prejudice to the rights of others. There may be circumstances which would justify such a tariff; there may have been extravagance and a needless expenditure

> of money; there may be waste in the management of the road; enormous salaries, unjust discrimination as between individual shippers, resulting in general loss. The construction may have been at a time when material and labor were at the highest price, so that the actual cost far exceeds the present value; the road may have been unwisely built, in localities where there is not sufficient business to sustain a road. Doubtless, too, there are many other matters affecting the rights of the community in which the road is built as well as the rights of those who have built the road.

It will thus be seen that the comparison of "actual cost" with "present value" was instituted to check "extravagance and a needless expenditure of money" or construction "at a time when material and labor were at the highest price *so that the actual cost far exceeds the present value.*" It is fundamentally the same principle which later found expression in the ruling of the Circuit Court of Appeals, First Circuit, that there should be proof that "a reasonably prudent man would purchase or undertake the construction of the property at such a figure." *U. S.* v. *Boston, Cape Cod & New York Canal Co., supra.*

The next important decision was the historic case of *Smyth* v. *Ames*, 169 U. S. 466 (1898), to which we respectfully recall the attention of the Court in considerable detail. The real question involved was the validity of a statute of Nebraska

under which railroad rates on the intrastate business were fixed so low that there would have been an actual loss on this business except that two of the companies involved would under certain exceptional conditions have earned something above operating expenses, the amount so earned, however, being in the opinion of the court "too small to affect the general conclusion that the act, if enforced, would have deprived each of the railroad companies involved in these suits of the just compensation secured to them by the Constitution" (p. 547).

The Court said (pp. 544, 545):

> A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the state. Such a corporation was created for public purposes. It performs a function of the state. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public. It is under governmental control, though such control must be exercised with due regard to the guaranties for the protection of its property. *Olcott* v. *The Supervisors*, 16 Wall. 678, 694; *Sinking Fund Cases*, 99 U. S. 700, 719; *Cherokee Nation* v. *Southern Kansas Railway*, 135 U. S. 641, 657. It can not, therefore, be admitted that a railroad corporation maintaining a highway under the authority of the state may fix its rates with a view solely to its own interests and ignore

> the rights of the public. But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the *fair value* of the property used for the public or the *fair value* of the services rendered, but in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders.
>
> If a railroad corporation has bonded its property for an amount that exceeds its *fair value*, or if its capitalization is largely fictitious, it may not impose upon the public the burden of such increased rates as may be required for the purpose of realizing profits upon such excessive valuation or fictitious capitalization; and the apparent value of the property and franchises used by the corporation, as represented by its stocks, bonds, and obligations is not alone to be considered when determining the rates that may be reasonably charged (pp. 544–545).

It will thus be seen that the court rejected both of the extreme contentions of the parties and the case could have been disposed of upon the ground that the statutory rates allowed practically no return on intrastate business above actual operating expenses. There was really no need to discuss what would constitute a proper rate base, but Mr. William J. Bryan was of counsel in the case, and he not only attacked the claim of the railroads for a return upon their outstanding capitalization (stocks

and bonds), but contended that the evidence showed that the railroads in Nebraska could be reproduced complete for about $20,000 per mile, which was very much less than the outstanding capitalization, and "that the present value of the roads as measured by the cost of reproduction is the basis upon which profit should be computed" (p. 489). The railroads had been largely constructed during and following the Civil War at the abnormally high prices then prevailing, and the cost of reproduction in 1897 would have been substantially less than original cost or prudent investment, even if either of these could then have been established by satisfactory evidence. It may be fairly said that it was the rejection of this "current reproduction cost" theory that was the outstanding feature of *Smyth* v. *Ames*. The arguments of counsel rather than the necessities of the record led the court into a consideration of the general principles affecting railroad-rate regulation and to the promulgation of the celebrated "rule":

> We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the *fair value* of the property being used by it for the convenience of the public (p. 546).

By subsequent adoption and repeated quotation this has become the "law of the land" but when it was first made, this statement was really *obiter* and

might well have been omitted, especially as the court had already said (p. 527):

> What are the considerations to which weight must be given when we seek to ascertain the compensation that a railroad company is entitled to receive, and a prohibition upon the receiving of which may be fairly deemed a deprivation by legislative decree of property without due process of law? Undoubtedy that question could be more easily determined by a commission composed of persons whose special skill, observation, and experience qualify them to so handle great problems of transportation as to do justice both to the public and to those whose money has been used to construct and maintain highways for the convenience and benefit of the people.

It was certainly without disclosing a clear appreciation of the difficulties involved that the court indulged in the assumption that somehow "value" could be determined by considering a lot of factors named and unnamed to which was to be given "such weight as may be just and right in each case." It attempted to reconcile or at least to recognize the irreconcilable contentions of the opposing counsel by saying:

> and, in order to ascertain that value the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the origi-

> nal cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration and are to be given such weight as may be just and right in each case (p. 546).

Having thus included "the outstanding bonds and stock" (for which the railroads contended) and "the present as compared with the original cost of construction" (not quite what was contended for by Mr. Bryan), the whole matter is turned over (under judicial protection against abuse) to the judgment of that expert commission which the court had already said could "more easily determine the great problems of transportation so as to do justice both to the public and to those whose money has been used to construct and maintain highways for the convenience and benefit of the people." The court was in reality merely indicating the evidence that was admissible and pertinent, and was carefully avoiding any suggestion as to the weight to be attached to any of that evidence. The "fair value" rule is a rule of evidence and not a measure or a formula. The difficulties it created are merely those that are inherent in the use of the word "value" as applicable to property "dedicated" to the performance of "a function of the State." The court said:

> We do not say that there may not be other matters to be regarded in estimating the

> value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth (p. 547).

The whole question was thus relegated again to the broad generalities of the previous decision of the court in *Covington & L. T. Co.* v. *Sandford*, 164 U. S. 578, from which the following language (already quoted) was taken:

> The utmost that any corporation operating a public highway can rightfully demand at the hands of the legislature when exerting its general powers is that it receive what under all the circumstances, is such compensation for the use of its property as will be just both to it and to the public (p. 546).

*Smyth* v. *Ames* was soon followed by *San Diego Land & Town Company* v. *National City*, 174 U. S. 739 (1899). The court repeated the so-called "rule" of *Smyth* v. *Ames* and also the language used in that case to the effect that the outstanding capitalization of the company does not furnish a proper rate base because it may be based upon excessive or fictitious values. The Court said:

> That it was competent for the State of California to declare that the use of all water appropriated for sale, rental, or distribution should be a public use and subject to public

regulation and control, and that it could confer upon the proper municipal corporation power to fix the rates of compensation to be collected for the use of water supplied to any city, county, or town, or to the inhabitants thereof, is not disputed, and is not, as we think, to be doubted. It is equally clear that this power could not be exercised arbitrarily and without reference to what was *just and reasonable as between the public and those who appropriated water and supplied it for general use;* for the State can not by any of its agencies, legislative, executive, or judicial, withhold from the owners of private property just compensation for its use. That would be a deprivation of property without due process of law. *Chicago, Burlington & Quincy Railroad* v. *Chicago*, 166 U. S. 226; *Smyth* v. *Ames*, 169 U. S. 466, 524. But it should also be remembered that the judiciary ought not to interfere with the collection of rates established under legislative sanction unless they are so plainly and palpably unreasonable as to make their enforcement equivalent to the taking of property for public use without such compensation as under all the circumstances is just both to the owner and to the public; that is, judicial interference should never occur unless the case presents, clearly and beyond all doubt, such a flagrant attack upon the rights of property under the guise of regulation as to compel the courts to say that the rates prescribed will necessarily have the effect to deny just compensation for private prop-

erty taken for the public use. *Chicago & Grand Trunk Railway* v. *Wellman*, 143 U. S. 339, 344; *Reagan* v. *Farmers' Loan & Trust Co.*, 154 U. S. 362, 399; *Smyth* v. *Ames*, above cited. See also *Henderson Bridge Co.* v. *Henderson City*, 173 U. S. 592, 614, 615.

In view of these principles, can it be said that the rates in question are so unreasonable as to call for judicial interference in behalf of the appellant? Such a question is always an embarrassing one to a judicial tribunal because it is primarily for the determination of the legislature or of some public agency designated by it. But when it is alleged that a State enactment invades or destroys rights secured by the Constitution of the United States a judicial question arises, and the courts, Federal and State, must meet the issue, taking care always not to entrench upon the authority belonging to a different department, nor to disregard a statute unless it be unmistakeably repugnant to the fundamental law (753–754).

*Cotting* v. *Kansas City Stock Yards Co.*, 183 U. S. 79 (1901), contains a searching analysis by Mr. Justice Brewer, of the character of railroad "property" and of the inherent limitations on its "private" title, reviewing the previous decisions including *Munn* v *Illinois* and *Smyth* v. *Ames*.

Six members of the court concurred in the judgment of reversal on the ground that the statute involved violated the equal protection clause of the Fourteenth Amendment, but recorded their avoid-

ance of commitment as to the constitutional question of the alleged taking of private property without due process of law.

There was, however, no reservation or divergence of opinion in the case of *M. & St. L. R. R.* v. *Minnesota*, 186 U. S. 257 (1902), when the court expressed the interpretation it then placed on the "fair value" rule of *Smyth* v. *Ames* (decided only four years before), as follows:

> Each case must be determined by its own considerations, and while the rule stated in *Smyth* v. *Ames* is undoubtedly sound as a general proposition that the railways are entitled to a fair return *upon the capital invested* it might not justify them in charging an exorbitant mileage in order to pay operating expenses, if the conditions of the country did not permit it (p. 268).

In *San Diego Land & Town Co.* v. *Jasper*, 189 U. S. 439 (1903), the court sustained the water rates fixed by the Board of Supervisors of San Diego County, California. The decision cited and followed *San Diego Land & Town Co.* v. *National City*, *supra*. In the course of the opinion by Mr. Justice Holmes, it was said:

> In a case like this we do not feel bound to re-examine and weigh all the evidence, although we have done so, or to proceed according to our independent opinion as to what were proper rates. It is enough if we cannot say that it was impossible for a fair-

minded board to come to the result which was reached (441–442).

* * * * *

The main object of attack is the valuation of the plant. It no longer is open to dispute that under the Constitution "what the company is entitled to demand, in order that it may have just compensation, is a fair return upon the *reasonable value* of the property at the time it is being used for the public." *San Diego Land & Town Co.* v. *National City*, 174 U. S. 739, 757. That is decided, *and is decided as against the contention that you are to take the actual cost of the plant, annual depreciation, etc., and to allow a fair profit on that footing over and above expenses.* We see no reason to doubt that the California statute means the same thing. Yet the only evidence in favor of a higher value in the present case is *the original cost of the work, seemingly inflated by improper charges to that account and by injudicious expenditures* (being the cost to another company, which sold out on foreclosure to the appellant), coupled with a recurrence to testimony as to the rapid depreciation of the pipes. No doubt cost may be considered and will have more or less importance according to circumstances. In the present case it is evident for reasons, some of which will appear in a moment, that it has very little importance indeed. (442–443.)

In *City of Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1 (1909), it was held that rate making is a legislative function whether exercised by the Legis-

lature or by a subordinate body to which power has been delegated, and that while courts may refuse to enforce legislation on constitutional grounds, the power should only be exercised in the clearest cases. The Court said:

> There can be at this day no doubt, on the one hand, that the courts, on constitutional grounds, may exercise the power of refusing to enforce legislation, nor on the other hand, that that power ought to be exercised only in the clearest cases. The constitutional invalidity should be manifest, and where that invalidity rests upon disputed questions of fact, the invalidating facts must be proved to the satisfaction of the court.

The case really turned upon the insufficient allowance made for depreciation. The court, however, summarized its previous decisions as follows:

> It can not be doubted that in a clear case of confiscation it is the right and duty of the court to annul the law. Thus, in *Reagan* v. *Farmers' Loan & Trust Company*, 154 U. S. 362, where the property was worth more than its capitalization, and, upon the admitted facts, the rates prescribed would not pay one-half the interest on the bonded debt; in *Covington & L. Turnpike Co.* v. *Sandford*, 164 U. S. 578, where the rates prescribed would not even pay operating expenses; in *Smyth* v. *Ames*, 169 U. S. 466, where the rates prescribed left substantially nothing over operating expenses and cost of service; and in *Ex parte Young*, *supra*, where, on the aspect of

> the case which was before the court, it was not disputed that the rates prescribed were in fact confiscatory, injunctions were severally sustained. But the case before us is not a case of this kind (p. 17).

On the same day as in the case last discussed, the court decided *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19. The Court said:

> The question arising is as to the validity of the acts limiting the rates for gas to the prices therein stated. The rule by which to determine the question is pretty well established in this court. The rates must be plainly unreasonable to the extent that their enforcement would be equivalent to the taking of property for public use without such compensation as, under the circumstances, is just both to the owner and the public. There must be a fair return upon the *reasonable value* of the property at the time it is being used for the public. *San Diego Land & Town Company* v. *National City*, 174 U. S. 739, 757; *Same* v. *Jasper*, 189 U. S. 439, 442.

The court reviewed at considerable length the history of the company and of the constituent or predecessor companies out of which it had been formed. Considerable discussion related to the rate of compensation and called attention to the fact that the monopolistic character of the business reduced the risk "almost to a minimum" so that "an interest in such a business is as near a safe and secure investment as can be imagined with regard

to any private manufacturing business, although it is reorganized at the same time that there is a possible element of risk, even in such a business." It was held that 6% was a fair rate of return, but that the value fixed by the trial court was much too large.

In view of the present contention that this court has made reproduction cost the controlling element or factor in determining "value," and in view of the effect of war prices upon any estimate of the present cost of reproduction, the following language of the court (already quoted) is particularly significant:

> And we concur with the court below in holding that the value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property which legally enters into the consideration of the question of rates has increased in value since it was acquired, the company is entitled to the benefit of such increase. This is, at any rate, the general rule. We do not say there may not possibly be an exception to it where the property may have increased so enormously in value as to render a rate permitting a reasonable return upon such increased value unjust to the public. How such facts should be treated is not a question now before us, as this case does not present it. We refer to the matter only for the purpose of stating that the decision herein does not prevent an inquiry into the

question when, if ever, it should be necessarily presented (p. 52).

The final conclusion of the court was as follows:

> Upon a careful consideration of the case before us we are of opinion that the complainant has failed to sustain *the burden cast upon it of showing beyond any just or fair doubt that the acts of the legislature of the State of New York are in fact confiscatory* (p. 54).

In the *Minnesota Rate Cases*, 230 U. S. 352 (1913), the court expressly rejected the doctrine of reproduction cost as it was sought to be applied to the real estate of a railroad company. The cases all involved the relation between state and interstate rates. After an elaborate review of the previous decisions, former Justice Hughes, the writer of the opinion, held that in view of the character of the legislation enacted by Congress up to that time, the State of Minnesota did not transcend the limits of its authority in prescribing certain intrastate rates provided these rates were reasonable. He then proceeded to consider the second question which he stated to be "Are the State's acts and orders confiscatory?" As to this he said:

> The rate-making power is a legislative power and necessarily implies a range of legislative discretion. We do not sit as a board of review to substitute our judgment for that of the legislature, or of the commission lawfully constituted by it, as to matters within the province of either. *San Diego Land &*

*Town Co.* v. *Jasper,* 189, U. S. 439, 446. The case falls within a well-defined category. Here we have a general schedule of rates, involving the profitableness of the intrastate operations of the carrier taken as a whole, and the inquiry is whether the state has overstepped the constitutional limit by making the rates so unreasonably low that the carriers are deprived of their property without due process of law and denied the equal protection of the laws.

The property of the railroad corporation has been devoted to a public use. There is always the obligation springing from the nature of the business in which it is engaged—which private exigency may not be permitted to ignore—that there shall not be an exhorbitant charge for the service rendered. But the state has not seen fit to undertake the service itself; and the private property embarked in it is not placed at the mercy of legislative caprice. It rests secure under the constitutional protection which extends not merely to the title, but to the right to receive just compensation for the service given to the public. (Citing cases.)

In determining whether that right has been denied, each case must rest upon its special facts. But the general principles which are applicable in a case of this character have been set forth in the decisions.

(1) *The basis of calculation is the "fair value of the property"* used for the convenience of the public. *Smyth* v. *Ames, supra* (p. 546), or, as it was put in *San Diego Land*

> *& Town Co.* v. *National City, supra* (p. 757), "What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public." See also *San Diego Land & Town Co.* v. *Jasper, supra; Willcox* v. *Consolidated Gas Co., supra.* (2) The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts" (433–434).

This language is followed by the quotation of the so-called "rule" laid down in *Smyth* v. *Ames*. This is followed by a full discussion of the method adopted by the Master in fixing value, which was based upon the estimates of expert witnesses as to what it would cost to reproduce the property, and in particular to reacquire the real estate included in the right of way and terminals. The opinion then said:

> These are the results of the endeavor to apply the cost-of-reproduction method in determining the value of the right of way. It is at once apparent that, so far as the estimate rests upon a supposed compulsory feature of the acquisition, it can not be sustained. It is said that the company would be compelled to pay more than what is the normal market value of property in transactions between private parties; that it would lack the freedom they enjoy, and, in view of

its needs, it would have to give a higher price. It is also said that this price would be in excess of the present market value of contiguous or similarly situated property. *It might well be asked, who shall describe the conditions that would exist, or the exigencies of the hypothetical owners of the property, on the assumption that the railroad were removed?* But, aside from this, it is impossible to assume, in making a judicial finding of what it would cost to acquire the property, that the company would be compelled to pay more than its fair market value. It is equipped with the governmental power of eminent domain. In view of its public purpose, it has been granted this privilege in order to prevent advantage being taken of its necessities. It would be free to stand upon its legal rights and it can not be supposed that they would be disregarded (450–451).

* * * * *

Moreover, it is manifest that an attempt to estimate what would be the actual cost of acquiring the right of way if the railroad were not there is to indulge in mere speculation. The railroad has long been established; to it have been linked the activities of agriculture, industry, and trade. Communities have long been dependent upon its service, and their growth and development have been conditioned upon the facilities it has provided. The uses of property in the communities which it serves are to a large degree determined by it. The values of prop-

> erty along its line largely depend upon its existence. It is an integral part of the communal life. The assumption of its nonexistence, and at the same time that the values that rest upon it remain unchanged, is impossible and can not be entertained. The conditions of ownership of the property and the amounts which would have to be paid in acquiring the right of way, supposing the railroad to be removed, are wholly beyond reach of any process of rational determination. The cost-of-reproduction method is of service in ascertaining the present value of the plant, when it is reasonably applied and may be ascertained with a proper degree of certainty. But it does not justify the acceptance of results which depend upon mere conjecture. It is fundamental that the judicial power to declare legislative action invalid upon constitutional grounds is to be exercised only in clear cases. The constitutional invalidity must be manifest; and if it rests upon disputed questions of fact, the invalidating facts must be proved. And this is true of asserted value as of other facts (452–453.)

It is to be noted that in the case at bar the Commission has "reasonably applied" the very best estimate of reproduction cost which could be made from the evidence available, but points out the extent to which the results "depend upon mere conjecture." In giving "due consideration to *all* of the elements recognized by the law of the land for rate-making purposes," it has not accepted as "controlling" or

"dominant" its own or any other estimate of the cost of reproducing the property. It has undertaken to find not its "original cost" but its "fair value" during each of the recapture periods, in accord with the following extract from the opinion in the *Minnesota Rate Cases*:

> It is clear that in ascertaining the present value we are not limited to the consideration of the amount of the actual investment. If that has been reckless or improvident, losses may be sustained which the community does not underwrite. As the company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in private ownership, and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law. But still it is property employed in a public calling, subject to governmental regulation, and while, under the guise of such regulation, it may not be confiscated, it is equally true that there is attached to its use the condition that charges to the public shall not be unreasonable. And where the inquiry is as to the fair value of the property, in order to determine the reasonableness of the return allowed by the rate-making power, it is not admissible to attribute to the property owned by the carriers a speculative increment of value over the amount invested in it and beyond

> the value of similar property owned by others, solely by reason of the fact that it is used in the public service. That would be to disregard the essential conditions of the public use and to make the public use destructive of the public right (454).

The court also said:

> The value of the use, as measured by return, can not be made the criterion when the return itself is in question. If the return, as formerly allowed, be taken as the basis, then the validity of the state's reduction would have to be tested by the very rates which the state denounced as exhorbitant. And, if the return as permitted under the new rates be taken, then the state's action itself reduces the amount of value upon which the fairness of the return is to be computed (461).

*Denver* v. *Denver Union Water Company*, 246 U. S. 178 (1918) involved the validity of an ordinance of the City of Denver establishing rates of a municipal water supply company whose franchise or right to occupy the streets had expired but which by the ordinance was directed to continue the service for an indefinite period. The Court construed the ordinance under which the city required the company to continue its operation "as the grant of a new franchise of indefinite duration, terminable either by the city or by the company at such time and under such circumstances as may be consistent with the duty they both owe to the inhabit-

ants of Denver." This court further held that if all the controverted items in the valuation were deducted the rates under the ordinance would have produced only 4.2812% on the value of the plant, while the prevailing rate of interest in Denver was about 6% on well secured loans, with higher rates for loans less adequately secured, and that the ordinance was, therefore, confiscatory upon any theory of the evidence. The case is often cited by railroads and public utility companies because of the statement in the opinion by Mr. Justice Pitney that "What we have said establishes the propriety of estimating complainant's property on the basis of present market values as to land and reproduction cost, less depreciation as to structures."

It is clear that this language is to be understood in the light of the peculiar facts in the case and of the adoption by the Master of the method thus indicated "with the practical consent of the parties" (p. 183). A vigorous minority dissent upon the main question was written by Mr. Justice Holmes and concurred in by Mr. Justice Brandeis and Mr. Justice Clarke. There is no discussion, however, of the *dictum* with regard to reproduction cost above quoted, and it can not be taken as the deliberate judgment of this court upon that particular subject, as it was wholly unnecesary to the decision.

In *Galveston Electric Company* v. *City of Galveston*, 258 U. S. 388 (1922), the opinion of the Court, by Mr. Justice Brandeis, showed (p. 390)

that, as in the *Denver Case*, the parties had proceeded by the same method. In the *Galveston Case*, there was an agreement upon the

> estimated undepreciated cost of reproduction on the historical basis; that is, what the property ought to have cost on the basis of prices prevailing at the time the system and its various units were constructed.

The parties then undertook to bring that valuation down to date by the use of index figures, representing (p. 392)

> prophecy as to the future general price level of commodities, labor, and money,

as to which there "was naturally wide divergence of opinion," the District Court and the Master adopting an intermediate figure. This Court in its opinion merely described this process and its result without approving it and because of the unreliability of the prophecies as to the effect of future prices upon the rates, which could and presumably would be readjusted by the Board of Commissioners, refused to hold that the rates already established would be confiscatory.

We now come to the three significant decisions in 1923 reported in the 262d United States Supreme Court Reports. In two of these cases the act of the State Commissions was held invalid because *no* consideration was given to current reproduction cost, while in the remaining case the State Commission was sustained because it did consider reproduction

cost, although it refused to accept the cost of reproduction at current prices of labor and materials as controlling. This was due to no inadvertence. The apparent inconsistency was specifically called to the attention of the court by Mr. Justice McKenna's dissent in the third case. The court preferred, however, to rest on the general rule of "fair value." It paid no more attention to this dissent than it had to the argument for "prudent investment" in the separate concurring opinion of Justices Brandeis and Holmes in the first of the three cases. This argument was not rejected for no attempt was made to meet it or discuss it in the majority opinion, which held that the case was controlled by the precedents cited. The court was evidently determined to keep the rule of "fair value" open and flexible and free from "formulas" of any sort.

In the first of these three cases, *Southwestern Bell Telephone Company* v. *Public Service Commission of Missouri*, 262 U. S. 276 (1923), the entire court united in a judgment of reversal of a decision of the Supreme Court of Missouri sustaining certain telephone rates. The majority opinion was written by Mr. Justice McReynolds and is based upon quotations from *Willcox* v. *Consolidated Gas Co.*, and *Minnesota Rate Cases*, supported by the citations of *Denver* v. *Denver Union Water Co.*, 246 U. S. 178, 191; *Newton* v. *Consolidated Gas Co.*, 258

U. S. 165; and *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, which are summarized as follows:

> It is impossible to ascertain what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances is essential. If the highly important element of present costs is wholly disregarded such a forecast becomes impossible. Estimates for to-morrow can not ignore prices of to-day (pp. 287–288).

We respectfully insist that there is no indication that the form in which was expressed this requirement of "an honest and intelligent forecast of probable *future* values" was intended to have the significance which has been subsequently claimed for it. It is perfectly sound as a declaration with respect to *rates*, but is not susceptible of rational application to the rate base or "value for rate-making purposes." Of course, the real question in all of the cases down to the present has been as to the reasonableness of the rates and the discussion of the rate base has only been an incident (although a most important one) in determining whether the *rates* are "just and fair" or are "confiscatory". In making rates for the future it is essential to consider probable results, and if those results are not as anticipated the rates can readily be changed.

But to attempt to forecast changes in the rate base due to anticipated changes in commodity or labor prices as affecting a hypothetical future reproduction cost is highly speculative and administratively impracticable. This is particularly true if it is supposed to be applicable to the railroad rate base or the recapture base under the provisions of the Transportation Act, especially where, as in the case at bar, adequate evidence is not available as to new railroad construction (excepting improvements or additions to existing railroads) or as to the effect of improved machinery or methods of construction or the effect of changes and improvements in new equipment.

Surely the Interstate Commerce Commission is given all the burden it can be expected to carry if in considering a proposed change in the national or regional rate structures in attempts to forecast the trend of operating costs and of interest and of dividend rates without imposing on it the duty of forecasting changes in the rate base that might result from an imaginary reproduction of the railroads at future prices of labor and materials. It is not only unsound as a principle as we have attempted to make clear, but the whole regulatory machinery would break down under the strain.

Mr. Justice Brandeis and Mr. Justice Holmes concurred in the judgment of reversal but dissented from the opinion (p. 289) "on the ground that the order of the State Commission prevents the utility

from earning a fair return on the amount prudently invested in it." Mr. Justice Brandeis wrote the separate opinion, which was largely devoted to a demonstration that—

> the so-called rule of *Smyth* v. *Ames* is, in my (his) opinion legally and economically unsound (p. 290).

In view of the extended discussion of this opinion and of the "prudent investment" theory in appellants' brief (pp. 81–88), we commend the opinion as a whole to the renewed consideration of this Court, contenting ourselves here with the following excerpts because of their direct bearing on the present controversy:

> Obviously each step in the process of estimating the cost of reproduction, or replacement involves forming an opinion, or exercising judgment, as distinguished from merely ascertaining facts. And this is true, also, of each step in the process of estimating how much less the existing plant is worth than if it were new. There is another potent reason why, under the rule of *Smyth* v. *Ames*, the room for difference in opinion as to the present value of a utility is so wide. The rule does not measure the present value either by what the utility cost to produce, or by what it would cost to reproduce, or to replace it. Under that rule the tribunal is directed, in forming its judgment, to take into consideration all those, and also other elements, called relevant facts.

Obviously "value" can not be a composite of all these elements, nor can it be arrived at on all these bases. They are very different; and must, when applied in a particular case, lead to widely different results. The rule of *Smyth* v. *Ames*, as interpreted and applied, means merely that all must be considered. What, if any, weight shall be given to any one, must practically rest in the judicial discretion of the tribunal which makes the determination. Whether a desired result is reached may depend upon how any one of many elements is treated. It is true that the decision is usually rested largely upon records of financial transactions, on statistics and calculations. But, as stated in *Louisville* v. *Cumberland Telegraph Co.*, 225 U. S. 430, 436, "every figure * * * that we have set down with delusive exactness" is "speculative" (pp. 294–296).

* * * * *

The opinion says:

The conviction is widespread that a sound conclusion as to the actual value of a utility is not to be reached by a meticulous study of conflicting estimates of the cost of reproducing new the congeries of old machinery and equipment, called the plant, and the still more fanciful estimates concerning the value of the intangible elements of an established business. Many commissions, like that of Massachusetts, have declared recently that "capital honestly and prudently invested must, under normal conditions, be taken as

> the controlling factor in fixing the basis for computing fair and reasonable rates."
>
> To require that reproduction cost at the date of the rate hearing be given weight in fixing the rate base may subject investors to heavy losses when the high war and post-war price levels pass and the price trend is again downward. The aggregate of the investments which have already been made at high costs since 1914, and of those which will be made before prices and costs can fall heavily, may soon exceed by far the depreciated value of all the public utility investments made theretofore at relatively low cost (pp. 301–303).

The opinion then dwells upon the "expense and loss now incident to recurrent rate controversies," and points out that "the most serious vice of the present rule for fixing the rate base is not the existing uncertainty; but that the method does not lead to certainty." The change in the situation since *Smyth* v. *Ames* is described to show that by reason of the increased powers of the Commissions it is now possible to know, with approximate definiteness, the amount and cost of capital actually expended upon the property. The previous decisions of this Court are reviewed to show that "value" is a word of many meanings. That with which the commissions and courts in these proceedings are concerned in so-called confiscation cases is a special value for rate-making purposes, not exchange value, and that estimates of the cost of reproduc-

tion must be based generally on the assumption that the identical property is to be reproduced, whereas a substitute property much less costly than the existing plant may furnish equal or better service.

It is clear that the *Southwestern Bell Telephone case* does not necessarily disclose a rejection of the principles so forcefully presented in the separate concurring opinion of Mr. Justice Brandeis and Mr. Justice Holmes. The majority opinion does not undertake even to discuss the many persuasive considerations presented in the separate opinion. The Court was united in the common conclusion reached by both the majority and the minority. Individual members of the Court might have simply reserved their own conclusions as to the soundness of the different views thus advanced. That this was the situation seems to be disclosed by the fact that at the same term of court the case of *Georgia Railway & Power Co.* v. *Railroad Commission of Georgia*, 262 U. S. 625, was decided, and the opinion was written by Mr. Justice Brandeis, who said:

> The refusal of the commission and of the lower court to hold that for rate-making purposes the physical properties of a utility must be valued at the replacement cost less depreciation was clearly correct.

There was only one member of the Court, Mr. Justice McKenna, who felt it necessary to dissent on the ground that this decision involved an inconsistency with the decision in the *Southwestern Bell*

*Telephone Co. case.* The very fact that he pointed out in a dissenting opinion the apparent conflict with the majority opinion in the *Southwestern Bell Telephone Co. case,* shows that this point was clearly brought to the attention of the Court, and none of his associates joined in his dissent. The *Georgia Railway & Power case* is expressly based upon the proposition that constitutional requirements were satisfied when "the Commission gave careful consideration to the cost of reproduction," although "it refused to adopt reproduction cost as the measure of value."

The opinion of the court stated the issues as follows:

> The objections mainly urged relate to the rate base, and one of them is of fundamental importance. The companies assert that the rule to be applied in valuing the physical property of a utility is reproduction cost at the time of the inquiry, less depreciation. The 1921 construction costs were about 70 per cent higher than those of 1914 and earlier dates, when most of the plant was installed. So much of it as was in existence January 1, 1914, was valued at an amount which was substantially its actual cost or its reproduction cost as of that date. The companies claim that it should have been valued at its replacement cost in November, 1921, the time of the rate inquiry, and that the great increase in construction costs was ignored in determining the rate base (p. 629).

As to this issue, it said:

> The case is unlike *Missouri ex rel. Southwestern Bell Telephone Co.* v. *Public Service Commission, ante,* 276. Here the commission gave careful consideration to the cost of reproduction; *but it refused to adopt reproduction cost as the measure of value.* It declared that the exercise of a reasonable judgment as to the present "fair value" required some consideration of reproduction costs as well as of original costs, but that "present fair value" is not synonymous with "present replacement cost," particularly under abnormal conditions. That part of the rule which declares the utility entitled to the benefit of increases in the value of property was, however, specifically applied in the allowance of $125,000 made by the commission to represent the appreciation in the value of the land owned. The lower court recognized that it must exercise an independent judgment in passing upon the evidence; and it gave careful consideration to replacement cost. But it likewise held that there was no rule which required that, in valuing the physical property, there must be "slavish adherence to cost of reproduction, less depreciation." It discussed the fact that since 1914 large sums had been expended annually on the plant; that part of this additional construction had been done at prices higher than those which prevailed at the time of the rate hearing; and it concluded that "averaging results, and remembering

> that values are * * * matters of opinion * * * no constitutional wrong clearly appears."
>
> The refusal of the commission and of the lower court to hold that, for rate-making purposes, the physical properties of a utility must be valued at the replacement cost, less depreciation, was clearly correct. As was said in *Minnesota Rate Cases*, 230 U. S. 352, 434: "The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts" (pp. 629–630).

*Bluefield Waterworks & Improvement Co.* v. *Public Service Commission of West Virginia*, 262 U. S. 679, is the last of the three important decisions contained in the same volume of the Supreme Court Reports (262 U. S.). It was decided June 11, 1923, the same day as the decision in the *Georgia Railway and Power case*. The opinion was written by Mr. Justice Butler. Mr. Justice Brandeis concurred in the *judgment* of reversal but expressly stated that this was for the reasons stated by him in the *Southwestern Bell Telephone case*. From the figures and quotations from the opinion of the Commission which are given in the opinion of Mr. Justice Butler, it appeared that the valuation fixed by the Commission was based entirely upon the financial records of the company as to the actual investment as reduced by estimates of depre-

ciation. The opinion, therefore, seems to turn upon what is stated to be the complete disregard of reproduction cost. The opinion says:

> It is clear that the court also failed to give proper consideration to the higher cost of construction in 1920 over that in 1915 and before the war and failed to give weight to cost of reproduction, less depreciation, on the basis of 1920 prices, or to the testimony of the company's valuation engineer, based on present and past costs of construction, that the property in his opinion was worth $900,000. The final figure, $460,000, was arrived at substantially on the basis of actual cost, less depreciation, plus ten per cent for going value and $10,000 for working capital. This resulted in a valuation considerably and materially less than would have been reached by a fair and just consideration of all the facts. The valuation can not be sustained. Other objections to the vaiuation need not be considered (p. 692).

The latest decision of the Supreme Court which requires consideration is *McCardle* v. *Indianapolis Water Co., supra,* decided November 26, 1926. In view of the reliance placed upon it by the appellants in the pending case, we ask the court to consider it at some length. It is not a railroad rate case. It is a local public utility—a municipal water company—whose rates are involved, and it is a company which, from the facts stated in the opinion, is entitled to extraordinary credit for having

created and developed an excellent water supply for a large and growing city whose water resources were meagre and whose need was desperate. While the *opinion* contains much discussion of reproduction cost, the *decision* is based squarely upon the interpretation of the decree of the trial court to the effect that the trial court did *not* give dominant or controlling weight to cost of reproduction. The opinion says (p. 162):

> While some expressions of the district judge indicate that he was of opinion that dominant or controlling weight should be given to cost of reproduction less depreciation estimated on spot prices as of January 1, 1924, it is clear that the $19,000,000 fixed by him as the minimum value could not have been arrived at on that basis.

It is this minimum valuation of $19,000,000 which the Supreme Court sustained after saying that (p. 163):

> While the facts stated in the court's decision are sufficient to sustain the decree, the findings as to value, the reasonable rate of return, and the net earnings are not as specific as good practice requires. As the litigation would be prolonged considerably if the case were remanded for further findings, we have examined the record to determine whether the facts proved justify the court's conclusion.

This and the somewhat extraordinary facts of the particular case doubtless explain why Mr. Justice

Holmes, who had concurred with Mr. Justice Brandeis in the *Southwestern Bell case*, was able to concur "in the result." Mr. Justice Brandeis and Mr. Justice Stone dissented, because they could not agree with the opinion of the majority with respect to what the District Judge had actually done; and because what he had done did not conform to the previous decisions of the Supreme Court and was not sound as a matter of principle. They also held that while the Supreme Court had—

> power to examine the evidence and to enter such decree as may be appropriate, * * * the better practice requires that the case be remanded to the district court so that the evidence may be reexamined there in the light of the applicable rules (p. 165).

The real basis of the "result" reached by the majority of the court is to be found in the following declaration of the opinion:

> The decision of this court in *Smyth* v. *Ames*, 169 U. S. 466, 547, declares that to ascertain value "the present as compared with the original cost of construction" *are, among other things, matters for consideration*. But this does not mean that the original cost or the present cost or some figure arbitrarily chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand.

These facts were decidedly impressive and are quoted in the opinion from the report of the Commission as follows:

> Petitioner has acquired and now owns the right or privilege of taking and using all the water in White River and Fall Creek for the purposes incident to its business. This right is an extraordinarily valuable part of the whole value of this property. The right to use the water of White River has saved the water company and likewise the citizens of Indianapolis *millions of dollars* over what it would have cost to secure sufficient water for the needs of the city in any other possible way. * * * The water company is entitled to share in the benefit of this valuable possession by reason of the fact that by its foresight, ingenuity, and initiative it has taken this stream of uncertain flow of impure water and has converted it into an immense asset both to itself and to the public. * * * This whole plant * * * has been planned and constructed with an ingenuity and economy and foresight for the future needs of the city that it is unequalled under any similar circumstances anywhere in the country. Indianapolis is probably the most unfortunately situated of any large city so far as the natural available water is concerned, yet the possibilities of an insignificant stream flowing through a thickly populated countryside have been so thoroughly developed that Indianapolis now has, and if it doubles in population will have, an ample

> supply of potent (potable) water at a cost much below the cost in many other cities more favorably located. This development of its water rights, which has been accomplished by the water company at times with extreme difficulty, does actually largely increase the value of the property.

The real basis of the decision is thus seen to be the "fair value" rule applied with special emphasis to the very unusual facts of the particular case. There is no attempt whatever to analyze or justify the "fair value" rule. It is simply reasserted as a matter of legal precedent, and as a rule requiring consideration of two things "among other things" requiring due consideration upon the authority of *Smyth* v. *Ames*. These two things are "the *present* as compared with the *original* cost of construction." But it is specifically laid down that "the weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand."

If neither the *original* cost nor the *present* cost nor some figure arbitrarily chosen between these two is to be taken as the measure, what does this mean? How can *both* of these elements be considered by any rational process or in any other way than "arbitrarily"—unless, indeed, it is to be the judgment of an expert Commission as to what is just and fair as between the public and a legalized monopoly which is to be fostered and developed as a governmental agency in the public service by

rates "sufficient to induce the investment of capital in the business and its continuance therein." The inherent impossibility of determining by any rational process the weight to be given to *both* of these factors is not in the slightest degree removed by saying that this is to be done "in the light of the facts of the case in hand." It is not possible to retain and use them both in any sense or *in any case in which reproduction cost is different from original cost; and to say that both are to be given "due consideration" only when they are exactly the same is to make a farce of the "fair value" rule.*

That this would be the necessary result of the language used in the opinion in the *Indianapolis Water Co. case* is apparent:

> Undoubtedly, the reasonable cost of a system of waterworks well planned and efficient for the public service, is good evidence of its value at the time of construction. And such actual cost will continue fairly well to measure the amount to be attributed to the physical elements of the property *so long as there is no change* in the level of applicable prices. And as indicated by the report of the commission, it is true that if the tendency or trend of prices is not definitely upward or downward, and it does not appear probable that there will be a substantial change of prices, then the present value of lands plus the present cost of constructing the plant less depreciation, if any, is a fair measure of the value of the physical elements of the prop-

> erty. The validity of the rates in question depends on property value January 1, 1924, and for a reasonable time following. While the values of such properties do not vary with frequent minor fluctuations in the prices of material and labor required to produce them, they are affected by and generally follow the relatively permanent levels and trends of such prices.

We shall not repeat here what we have already said as to the economic and legal unsoundness of this conception of "value" and of its determination in railroad rate regulation. What the advocates of "spot" reproduction cost would really accomplish is to destroy the fair value rule of *Smyth* v. *Ames* (even as it is reaffirmed in the Indianapolis case) and to substitute for it the rule that when (*and this would for all practical purposes be always*) reproduction cost is different from original cost (or original cost excluding so much thereof as was dishonest or grossly improvident), then original cost is to be completely discarded and reproduction cost alone is to determine the rate base. It may be conceded that the *statements* or *dicta* of the *Indianapolis Water Co.* opinion go further in that direction than has ever before been permitted by the majority of the Supreme Court, but that they are still *dicta* is apparent from the fact that if the *language* in the decision had really been followed, the amount allowed would have far exceeded the $19,000,000. The really significant thing is that not

only the writer of the court's opinion but the Water Company rested their defense of the decree of the District Judge upon the fact that he did not proceed upon any such theory of reproduction cost as is set forth in the *language* of the opinion. The opinion said (p. 155):

> Appellants contend that the court adopted as the measure of value the cost of reproduction new less depreciation, estimated on the basis of spot prices as of January 1, 1924, or gave that figure controlling weight. The appellee says that the cost of reproduction less depreciation, estimated at such prices, was shown to be more than $22,500,000 and that the court did not adopt such costs as a measure or give them undue weight as evidence of value.

The decree of the District Court—

> held that the amount as found by the commission was less than the fair value of the property as of January 1, 1924, by more than $3,500,000, and that "the fair value of complainant's said property at said time was and is not less than $19,000,000."

The opinion of the Court devoted much space to an analysis of the evidence as to values, as of three different dates involved in three different rate proceedings and shown in the record, from which it appears that the company's evidence would support a total claim of more than $25,000,000, upon the basis of reproduction cost as of December 31, 1923, *plus* approximately $3,000,000 for working capital.

water rights, and going value. It will thus be seen how far the *decision* falls short of sustaining the reproduction cost theory elaborated in the opinion.

It is unnecessary to review here either *The New England Divisions case, supra,* or *Dayton-Goose Creek Ry. Co.* v. *United States, supra,* to which we have already endeavored to give the consideration demanded by their importance. They sustain and expound the constructive provisions of the Transportation Act and show how extensively and vitally it has changed the conditions and the problem of railroad regulation. That problem can not be rightly solved until old decisions are reexamined in the light of the new conditions. It can be rightly solved in no narrow legalistic spirit of adhesion to old *dicta,* no matter how often they may have been repeated. This Court stands committed to no precedent that conflicts with the order of the Commission in the O'Fallon case; but if there were such a precedent, its unwisdom would be apparent in the light of the clearer conceptions of public policy embodied in the Transportation Act and included within the scope of the Commerce Clause of the Constitution, as interpreted in the *Dayton-Goose Creek case.*

SINGLE SYSTEM

Many pages of appellants' brief are devoted to the claim that the Commission's order is invalid because it did not find that the O'Fallon and the Manufacturers Railroads constituted a single system.

The Transportation Act provides that recapturable excess earnings shall be determined annually for each and every interstate railroad as a separate entity. It then provides by way of exception to this general rule that—

> For the purposes of this paragraph the value of the railway property and the net railway operating income of a group of carriers, *which the Commission finds* are under common control and management *and are operated as a single system*, shall be computed for the system as a whole irrespective of the separate ownership and accounting returns of the various parts of such system. (Sec. 15a) (6). (Italics ours.)

The Commission did not "find" that the O'Fallon and the Manufacturers "are operated as a single system." This would, therefore, seem to be the end of the matter, and that this would be the result of the Commission's failure to make an affirmative finding in favor of appellants was not only conceded before the Commission by Mr. Edgar E. Clark, their representative, but it was affirmatively urged by him as a reason why the Commission should give careful consideration to this particular matter. This is a part of the record presented to this Court by the appellants. His position is not only in accord with the decisions of the Supreme Court in *Procter and Gamble Co.* v. *U. S.*, 225 U. S. 282, and *Lehigh Valley Railroad* v. *U. S.*, 243 U. S. 412, but is in accordance with the numerous decisions in which

this Court has held that the judgment of the Commission with respect to matters of fact which are peculiarly within its province should not be disturbed unless shown to be plainly willful or arbitrary.

*Illinois Central R. R. Co.* v. *Interstate Commerce Commission*, 206 U. S. 441.

*Interstate Commerce Commission* v. *Union Pacific R. R. Co.*, 222 U. S. 541.

*Florida East Coast Ry Co.* v. *U. S.*, 234 U. S. 167.

*U. S.* v. *New River Co.*, 265 U. S. 533.

*Virginian Railway Co.* v. *U. S.*, 272 U. S. 658.

Mr. Clark's statement to the Commission was (R. 649):

> Now, as to many of these important questions regarding valuation, the law provides for judicial review; but in this instance that I am discussing there is no such provision, and it is my deliberate judgment that there is no appeal from the decision of the Commission as to whether or not these roads form a system within the meaning of that paragraph, unless it would be under inconceivable circumstances where the Commission exercised a power or a discretion that was so arbitrary as to fall outside the four corners of the act.

The Commission did give its careful consideration to the question of fact as to whether the O'Fallon and Manufacturers Railroads were "operated as a single system," and it found that they

were not so operated. It may also be noted that, in a letter to the Commission found in the Record, Mr. Marsh, the auditor and treasurer of both companies, stated:

> I wish to say, for your information, that the St. Louis and O'Fallon Railway and the Manufacturers Railway are owned by the same people and are operated separately. (R. 626.)

It is not only that these roads are not physically connected, although they have the right to have their cars transported over the lines of the St. Louis Terminal, under the decree to which so much space is needlessly devoted. They operated engines and other equipment from one line to the other over the intervening tracks of the Terminal, but there is no written contract or other provision for such use, and a special arrangement is made for each movement. (R. 294–296.) Due to the difference in traffic handled by the Manufacturers and the O'Fallon (R. 294) there is no occasion for regular through operation of trains over the lines of these carriers (R. 298, 444). Only a very small percentage of the traffic originating on the O'Fallon moves to points on the Manufacturers, and practically no traffic moves from the Manufacturers to the O'Fallon. While it is claimed that the primary purpose of the acquisition of these properties by the Busch interests was the future combining of the two properties, they never have been combined, and at one time Mr. Busch considered mak-

ing a separate sale of the O'Fallon, and an option was actually given for the sale of the coal mines and the O'Fallon, which did not embrace the Manufacturers. (R. 436.) The Manufacturers is purely a switching road, moving cars between various industries and the trunk lines running from St. Louis or the line of the Terminal Railroad Association of St. Louis. It issues no way bills, but issues receipts to shippers, and it submits bills of lading to the trunk lines by which regular way bills are made out. (R. 294.) Other significant facts are mentioned in the Report of the Commission.

Sixty-five shares of the capital stock of the Manufacturers are not owned by the Busch interest. (R. 292.) Appellants' claim is really based on the proposition that Mr. Busch "intended" to connect these railroads if and when in some still remote future he became able to use the Municipal Bridge for that purpose, and that while waiting for this doubtful eventuality the common financial control has led to the employment of the same people as officials, etc. This falls far short of establishing that these roads are now or ever have been operated as a single system. The secret lies in what appellants call "the common pocketbook" argument, which is that if the same people own the controlling financial interest in two railroads the excess earnings of one of these roads are to be used first to make up a deficit on the other road before there is any recapture of the excess on the more profit-

able road. There is not the slightest evidence that Congress in fact had any such intention, and the attempt to deduce such an intention from the provisions of the Act is extraordinarily forced and unsound. It is interesting to note that this treatmen of excess earnings is to be applied only to the computations to be made by the Commission. It is sufficient to say that so far as this Record discloses there is not and never has been any common pocketbook of the two railroads. It is the Busch pocketbook that is common, and it may be safely assumed that so long as the sixty-five shares of capital stock do not belong to that pocketbook there will be no use of the revenues of the O'Fallon for the benefit of the stockholders of the Manufacturers.

Appellants' "common pocketbook" argument would apply with equal force to two railroads widely separated if they were owned by and financed out of the pocketbook of the same owner. That Congress meant something very different is shown by the fact that the Act refers in no way to common ownership, and authorizes the Commission to treat as a single system for purposes of recapture of excess earnings, two or more roads only if the Commission finds that they are "under common control and management *and are* operated as a single system." The requirement of "operation as a single system" was to prevent any such contention as appellants are here making, because as appellants themselves say (brief p. 116):

> Congress evidently had in mind that the same pocketbook might both *control* and *manage* railroad properties, the "operation" of which does not resemble that of a single system.

The "operation" of these roads as distinguished from their "common control and management" is in no respect different from what it would have been if the Manufacturers were separated from the O'Fallon by many miles of connecting track belonging to some other carrier and yet was under the same control and management. We find in the Act no such "helpful purpose" to extend direct financial assistance to a weaker carrier without utilizing the recapture fund. Why should the O'Fallon be relieved of any recapture of its large excess earnings merely because its owners are also owners of the great majority of the capital stock of another railroad whose minority stockholders never participate directly nor indirectly in the earnings of the O'Fallon?

Appellants (brief p. 135) challenge the following finding of the District Court:

> But *here* these two carriers *have no traffic carrying or operating unity* except for *the small amount of coal delivered to the Manufacturers* from the O'Fallon and *no financial interdependence*. Therefore, we think, *the Commission correctly held* these two carriers *not* to be "*operated* as a single system" within the meaning of this statute (R. 136),

and particularly (brief p. 136) the finding of the Commission that

> *Only a very small percentage* of the traffic *originating* on *the O'Fallon* moves *to points on the Manufacturers.*

In view of the emphasis placed upon the matter in appellants' brief, we are compelled to ask the indulgence of the Court to a more extended discussion than we would otherwise regard as warranted.

Aside from the general allegations contained in the petition (R. 10) that the conclusion of the Commission that appellants' railroads were not operated as a single system during the recapture periods is—

> contrary to the uncontradicted evidence before the Commission. It is also contrary to all the relevant facts, including those before the Commission.

and (R. 29) that—

> (f) The action of the Commission, evidenced by said order, is arbitrary in that such action is not only not supported by the evidence, but, as above alleged, the Commission's findings are contrary to the undisputed evidence before it,

the particular finding of the Commission now challenged was not specifically challenged in the District Court. What was there claimed was (Dist. Ct. Brief p. 78):

> There is a steady movement of coal from mines on the O'Fallon to industries on the Manufacturers (Narr. St., Vol. 1, p. 13).

> The Manufacturers handles a very large percentage of coal, a great deal of which comes from the O'Fallon (Narr. St., Vol. 1, p. 16).

It is to be noted that these claims might be correct and yet that it may be true that—

> Only a very small percentage of the traffic originating on the O'Fallon moves to points on the Manufacturers.

This particular statement is not at all essential to the Commission's finding that the two railroads were not "operated as a single system." Nevertheless, the record here contains sufficient support for this statement by the Commission and by the District Court. The exhibit shown (R. 582) as Exhibit 37 (should be 39), gives the total carloads of freight carried by the O'Fallon for the years 1920–1923, both inclusive, varying from 32,704 to 20,502 carloads, and it also appears of record here (R. 299) that:

> At least 99% of the total traffic of the O'Fallon consists of coal; it all moves westbound.

The Manufacturers is a switching road. Similar statistics as to carloads are not available as to it. It handles 50,000 loaded cars yearly (R. 372); and "the traffic of the Anheuser-Busch Brewing Association constitutes 25% of the total of the line." (R. 296.) "There are about 26 lines making delivery besides the O'Fallon." (R. 444.) The Manufacturers "does not act as an intermediate for traf-

fic from trunk lines to the O'Fallon" (R. 374), "nor has the Manufacturers any participation in the O'Fallon coal business except when the coal is billed to the Manufacturers" (R. 299). "The great bulk of the Manufacturers' business is the switching of cars for the connecting trunk lines." (R. 297.)

Appellants' brief in this Court claims (pp. 135, 136) that

> The record before the Commission contains no proof of the total amount of coal originating at the mines on the O'Fallon, that moved during the whole of any recapture year to consignee located on the Manufacturers. There is, however, an exhibit (R. 639–642) showing the number of such movements during one month (August) in the summer of 1924. It shows a total of 222 cars of coal. Obviously, coal movements during the hot midsummer month of August would represent the minimum, rather than a fair average, of monthly movements during the entire year. It is, therefore, a fair inference that the *average* monthly movements of coal from the mines on the O'Fallon to consignees on the Manufacturers substantially exceeded 222 cars.

If we may assume that the 222 cars of coal handled in the month of August, 1924, to which appellants refer, was a fair monthly average for the year, which must have been contemplated in the introduction of the exhibit, then the annual total

would be 2,664 cars. This annual total would be only 8% of the total cars of coal handled by the O'Fallon in the year 1920, as shown in the exhibit (R. 582) above mentioned, 12% for the year 1921, and 13% for each of the years 1922 and 1923. The witness Wright, Secretary of the Manufacturers, testified (R. 299) that the latter two years were characterized by such "extreme dullness in the coal business" that "the coal traffic of all lines in Illinois * * * has not been 40% of normal."

What difference, if any, exists in the volume of coal traffic between summer and winter on a switching railroad serving an industrial and terminal district in which the vast majority of industries are manufacturing plants (R. 374), whose boilers consume coal in summer as well as in winter, does not appear. But granting *arguendo* the inference of the appellants

> that the *average* monthly movements of coal from the mines on the O'Fallon to consignees on the Manufacturers substantially exceeded 222 cars

there would still be "Only a very small percentage of the traffic originating on the O'Fallon" moving "to points on the Manufacturers." Other indisputable features of the operating relationship between the two roads are, however, of a greater and more determining importance as to their *operation* "as a single system."

INTEREST

The Commission respectfully contends that the trial court erred in requiring a modification of the recapture order with respect to the dates from which interest should be paid. The statute provides in Section 15a, paragraph (9), that

> The Commission shall prescribe rules and regulations for the determination and recovery of the excess income payable to it under this section, etc.

The rule adopted with respect to interest was that

> Interest on amounts of excess railway operating income payable to the United States under the provisions of Section 15a will be required at the rate of 6% per annum, beginning four months after the termination of the period for which the said excess income is computed. (Commission's report, p. 44.)

This follows the Transportation Act, which provides in Section 15a, paragraph (6), that

> If under the provisions of this Section any carrier receives for any year a net railway operating income in excess of six per centum of the value of the railway property held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund established and maintained by such carrier, and the remaining one-half thereof shall, *within the first four months following the close of the period for which such computation is made*, be recoverable by and paid to the Commission for the purpose of

> establishing and maintaining a general railroad contingent fund as hereinafter described. (Italics ours.)

This fixes the date when payment is to be made, and it does not require any demand or other action by the Commission. If there is in fact recapturable excess, the payment must be made within the first four months following the close of the period for which the excess earnings are computed. The importance of the matter does not consist of the amount of interest recovered in this case or in other cases, but in the incentive offered to procrastinate and contest the amount recoverable if interest does not run until after the Commission has entered a formal order.

**THE ESTABLISHMENT OF RATES THAT WILL ACTUALLY PRODUCE THE "FAIR RETURN" CONTEMPLATED BY SECTION 15a IS NOT A CONDITION PRECEDENT TO THE OPERATION OF THE RECAPTURE PROVISIONS**

Congress realized the practical difficulty of establishing rates which would allow precisely the amount of revenue required to constitute a fair return on the value of the property. Recognition of this difficulty resulted in the inclusion of the phrase "as nearly as may be" in the portion of the statute under consideration. This is the interpretation which has been placed upon the statute by the Commission. In *Reduced Rates*, 1922, 68 I. C. C. 676, 680, it said:

> By the qualifying words "as nearly as may be" Congress recognized that conditions dur-

ing certain periods might prevent such realization under any adjustment of rates.

The Commission is only directed to fix rates which it may reasonably expect will produce the fair return contemplated by Congress. The Commission has unquestionably endeavored to accomplish this result. The whole idea that the Act intended anything whatever in the nature of a guaranty is refuted by the Congressional Reports and Debates, and was repudiated by Daniel Willard, President of the Baltimore & Ohio Railroad Company, in the address from which we have already quoted. It is difficult to see how this claim can be made or sustained on behalf of a carrier which has admittedly earned more than the "fair return" established by the Commission and has earned this as a result of rate increases made under the Act for the purposes of benefiting other and less profitable carriers.

**RECAPTURE MUST BE EFFECTIVE ON EXCESS EARNINGS AFTER THE EFFECTIVE DATE OF THE ACT**

The Transportation Act became effective on and after the date of its passage, which was February 29, 1920. There is no statute fixing the time when acts of Congress will take effect, but it is well settled that where no other time is prescribed they take effect from their date.

*Lapeyre* v. *U. S.*, 17 Wall. 191.
*Matthews* v. *Zane*, 7 Wheat. 164, 211.
*Robertson* v. *Bradbury*, 132 U. S. 491.

Existing rates, fares and charges were continued in effect until changed by state or federal authority. (Transportation Act, Sec. 208a, 41 Stat. L. 464). Immediately upon the passage of the Act, the Commission instituted steps to establish rates which would accomplish its purpose, and set for oral argument on March 22, 1920, the question whether rate adjustments should be made by rate groups or by carriers as a whole. Applications for increases in rates were filed by carriers in the latter part of April and the early part of May, 1920, at the suggestion of the Commission. Hearings were held in May, June, and July, 1920, briefs were submitted and oral argument heard July 6th. On July 29, 1920, the carriers were authorized to place the increased rates in effect upon five days' notice to the Commission and to the general public. The above facts appear in the decision of the Commission in *Increased Rates* 1920, 58 I. C. C. 220, introduced in evidence by reference. The Commission clearly proceeded with reasonable diligence, and has regarded it as its duty under the statute to calculate recapture of excess earnings from and after the passage of the Act on March 1, 1920.

**THE "RESERVE FUND" PROVISIONS DO NOT INVALIDATE THE ACT OR THE ORDER**

While this point is presented in appellants' brief as a separate point, it is directly involved in the claim that the constitutional question of confisca-

tion is presented in this case, which we have already discussed. (See pp. 63–66, supra.)

**THE STATUTORY COURT DID NOT ERR IN REFUSING TO GRANT THE APPELLANTS A TRIAL DE NOVO IN COURT OR IN SUSTAINING OBJECTIONS TO EVIDENCE OFFERED IN COURT DIFFERENT FROM AND IN ADDITION TO THAT SUBMITTED IN HEARINGS BEFORE THE COMMISSION**

During the trial before the Statutory Court attorneys for the appellants produced a certified copy of the record before the Commission, had it marked for identification as Appellants' Exhibit No. 3, and offered it in evidence, in the following terms: "We offer this record before the Commission in evidence not only as the record before the Commission itself but we offer its entire contents as evidence *de novo* in court." (R. 178.) During the further course of the hearing other documents and testimony were offered by the appellants, which had not been submitted to the Commission at the hearings before it, upon their theory that they were entitled to a trial *de novo* in court of issues in this case. (R. 277–286.)

To the offers by the appellants of each and all matters of evidence *de novo* objections were interposed by the appellees. These objections were sustained by the court in a separate opinion. (R. 179–180.)

There was no objection on the part of the appellees to the receipt in evidence of the certified record before the Commission for the purpose of disclosing proceedings taken by the Commission

and evidence upon which it acted in making the order under attack in the present case.

Briefly, the theory upon which the appellants based their contention that they were entitled to a trial *de novo* and to introduce evidence not presented before the Commission was that the allegations in the petition that the Commission's order confiscated their property and, if enforced, would cause the appellants irreparable damage, raised justiciable and judicial questions upon which the appellants conceived that they were entitled to the independent judgment of the court as to both law and facts. (R. 178.)

The principal grounds of objection were: (1) that the court was without jurisdiction to review the findings of the Commission that the two carriers were not a group of carriers under common control and management and operated as a single system within the meaning of paragraph 6 of Section 15a, and was accordingly without jurisdiction to receive evidence on that subject; (2) that in a proceeding before the District Court where the appellants sought to enjoin, set aside, annul, or suspend an order of the Interstate Commerce Commission, a trial *de novo* was not contemplated by law, and evidence in addition to that received by the Commission was not proper for the reason that the record of the evidence and proceedings before the Commission and on which it based its order was the only record or evidence upon which the valid-

ity of that order could be determined; (3) that there was no claim that the new evidence offered was newly discovered or that it was not in the possession of the parties at the time of the hearings before the Commission, or that the Commission had ever refused to hear it or to grant the appellants a rehearing for the purpose of receiving it; (4) that if only questions of statutory construction were presented evidence *de novo* was not admissible to aid in interpreting the statute or the evidence before the Commission or for the purpose of supplementing or amplifying the evidence before the Commission to show that it was wrong; and (5) that it was contrary to orderly procedure and practice to seek to build up a new record to destroy the order of the Commission which should be tested solely by the sufficiency of the record before it at the time it entered its order. (R. 179–180.)

There is no contention that the Commission did not grant a full and fair hearing to the appellants in the proceedings in which the order under attack was issued. It is not contended even that any evidence which the appellants sought to introduce was refused or rejected by the Commission. The purpose of the present proceeding is to have the order which the Commission made enjoined, set aside, annulled, and suspended on the ground that the Commission exceeded its lawful powers and authority. Whether or not such ground is well founded can depend only, so far as questions of fact are

concerned, upon what the proceedings taken by the Commission were and upon what the evidence before it was. The question is whether the order was valid in the light of what the Commission did under the law with the evidence it had before it, not whether the order might be valid or otherwise in the light of a different record or upon a different set of facts and circumstances.

It is the Interstate Commerce Commission and not the courts to whom Congress has delegated the authority to administer the Interstate Commerce Act, and particularly Section 15a thereof, pursuant to which the order here under attack was made. The functions involved are administrative and legislative and can not be imposed upon the courts. *Keller et al.* v. *Potomac Electric Power Co.*, 261 U. S. 428. Aside from consideration of the burdensome duties which the courts would be obliged to assume if the petitioners were correct and if every case brought to set aside orders of the Commission in recapture cases required the courts to hear it *de novo*, there is the further consideration that the courts consistently decline to interfere with the Commission in the exercise of its administrative functions as the agent of Congress, and decline to substitute their judgment for the judgment of the Commission in matters properly committed to it for determination. The courts have definitely established the rule that they will enjoin the Commission's orders and declare them null and void

only for errors of law, in cases in which the Commission has exceeded its powers under the law or has failed to observe the requirements of the law which confers its powers, or in cases in which the Commission acts arbitrarily and without evidence to support its findings and conclusions or where the effect of the order of the Commission is to deny the party any rights which he may enjoy under the Constitution of the United States.

*Cincinnati, New Orleans & Texas Pacific Ry. Co.* v. *I. C. C.*, 162 U. S. 184, 196.

*United States* v. *New River Co.*, 265 U. S. 533.

*Procter & Gamble Co.* v. *United States*, 225 U. S. 282, 297.

*Illinois Central R. R. Co.* v. *I. C. C.*, 206 U. S. 441, 454.

*I. C. C.* v. *Union Pacific R. R. Co.*, 222 U. S. 541, 546.

It is neither essential nor desirable that any evidence in addition to that submitted before the Commission be received in court to enable the court to review the Commission's orders and determine any of such questions, which the courts hold are the only questions properly before them in a proceeding such as the present one.

The appellants have directed attention to no case in which this Court has ever held that a party contesting an order of the Commission was entitled to a trial *de novo* in court, or to introduce evidence in addition to that before the Commission.

Apparently they infer that they have such a right because of what the Court has said, to the effect that the right of judicial review may not be so limited by legislation as to prevent the courts from exercising their independent judgment as to the law and facts in cases in which the issue of confiscation is presented. No good reason has been advanced to show that courts may not determine questions of confiscation, in cases where that question is properly presented, by consideration of evidence submitted before the regulatory commission without the introduction in court of additional evidence, which the tribunal that made the order under attack has had no opportunity to consider. It does not follow from the doctrine that legislation may not prevent a proper judicial review that in order to insure such review the court must receive evidence not before the Commission. A "review" implies a re-examination of the proceedings of the tribunal whose action is under consideration, and not an examination of a different record, made thereafter, upon a trial *de novo*.

The sole authority upon which appellants rely is the case of *Manufacturers Railway Company* v. *Interstate Commerce Commission*, 246 U. S. 457. That was a suit brought to enjoin the enforcement of orders made by the Interstate Commerce Commission fixing rates and divisions of rates for common carriers subject to the Interstate Commerce Act. During the trial in the District Court evi-

dence in addition to that presented to the Commission was admitted, and such evidence was reviewed by this Court in the opinion by Mr. Justice Pitney. The Court, however, very positively disapproved of the practice of withholding from the Commission "evidence * * * alleged to show the rate in question to be confiscatory."

After stating its conclusion, as to which there should have been no question, "that matters of constitutional right are not to be conclusively determined by the Commission," and that the Court was "not prepared to say that a party is debarred from attacking an order of the Commission upon constitutional grounds even though they were not taken in the hearing before that body," the Court said (p. 489):

> Nevertheless, correct practice requires that, in ordinary cases, and where the opportunity is open, all the pertinent evidence shall be submitted in the first instance to the Commission, and that a suit to set aside or annul its order shall be resorted to only where the Commission acts in disregard of the rights of the parties. This was recognized before the amendment of 1906, and when by §§ 14, 15, and 16 of the original Act of February 4, 1887, c. 104, 24 Stat. 379, 384, as amended by Act of March 2, 1889, c. 382, 25 Stat. 855, the findings made by the Commission upon questions of fact were limited in their effect to that of *prima facie* evidence in all cases and not only, as now, in repa-

ration cases. *Cincinnati, New Orleans & Texas Pacific Ry. Co.* v. *Interstate Commerce Commission,* 162 U. S. 184, 196; *Texas & Pacific Ry. Co.* v. *Interstate Commerce Commission,* 162 U. S. 197, 235, 238; *Louisville & Nashville R. R. Co.* v. *Behlmer,* 175 U. S. 648, 675; *East Tennessee, &c., Ry. Co.* v. *Interstate Commerce Commission,* 181 U. S. 1, 26; *Illinois Central R. R. Co.* v. *Interstate Commerce Commission,* 206 U. S. 441, 454.

The 1906 amendment, in modifying § 14 so as to dispense with the necessity of formal findings of fact except in cases where damages (or reparation) are awarded, and §§ 15 and 16 so as to give a greater effect than before to the orders of the Commission other than those requiring the payment of money, renders it not less but more appropriate that, so far as practicable, all pertinent objections to action proposed by the Commission and the evidence to sustain them shall first be submitted to that body. Hence, we can not approve of the course that was pursued in this case, of withholding from the Commission essential portions of the evidence that is alleged to show the rate in question to be confiscatory.

The Court stated its reason for giving consideration to the new evidence introduced in the District Court in these words (p. 490): "However, the issue is in the case and must be dealt with." It is clear that "the issue" referred to was that of confiscation which, of course, the Court could not avoid.

Appellants attempt to distinguish between administrative orders of the Commission and those which involve no constitutional question. They assert that as to "orders of an administrative nature • • • the courts have regarded themselves as limited to the narrower scope of judicial review accorded where no constitutional question is presented." The Court in the *Manufacturers' Railway case* makes no such distinction. It clearly negatives the idea that such a distinction exists when it says (p. 499):

> It is true that so long as the Commission proceeds in accordance with the requirements of the Commerce Act and its amendments, *and with proper regard for constitutional restrictions, its administrative orders,* not calling for the payment of money, if made after due hearing and supported by evidence, are not subject to attack in the courts.

This is plainly but another way of saying that, if the Commission's administrative orders are not made "with proper regard for constitutional restrictions," they are subject to attack in the courts, because questions of constitutional right can not be "conclusively determined by the Commission." The constitutional question of confiscation was clearly presented in the *Manufacturers' case* and it was in the opinion in that case that the Court disapproved withholding from the Commission evidence alleged to prove confiscation.

In *L. & N. R. R. Co.* v. *U. S.*, 218 Fed. 89, the court excluded evidence which was not before the Commission in a case involving confiscation.

In *Interstate Commerce Commission* v. *Union Pacific R. R. Co., supra,* the Court said (p. 547):

> In determining these mixed questions of law and fact, the court confines itself to the ultimate question as to whether the Commission acted within its power. It will not consider the expediency or wisdom of the order, or whether, on like testimony, it would have made a similar ruling. "The findings of the Commission are made by law *prima facie* true, and this court has ascribed to them the strength due to the judgments of a tribunal appointed by law and informed by experience.

In *Procter & Gamble Co.* v. *United States, supra,* the Court said (pp. 297, 298):

> Originally the duty of the courts to determine whether an order of the Commission should or should not be enforced carried with it the obligation to consider both the facts and the law. But it had come to pass prior to the passage of the act creating the Commerce Court that in considering the subject of orders of the Commission, for the purpose of enforcing or restraining their enforcement, the courts were confined by statutory operation to determining whether there had been violations of the Constitution, a want of conformity to statutory authority, or of ascertaining whether power had been so ar-

bitrarily exercised as virtually to transcend the authority conferred although it may be not technically doing so.

In *United States* v. *New River Company, supra,* the Court said (pp. 540, 542):

> The authority conferred upon the Commerce Court by § 207 of the Judicial Code was vested in the District Courts by the Act of October 22, 1913, and, like the authority previously exercised by the Federal Circuit Courts, is confined to determining whether the Commission's order violates the Constitution, or exceeds the power delegated by statute, or is an exercise of power so arbitrary as virtually to transcend the authority conferred.

Continuing, the Court said:

> The courts will not review determinations of the Commission made within the scope of its powers or substitute their judgment for its findings and conclusions.

In *Cincinnati, New Orleans & Texas Pacific Ry. Co.* v. *Interstate Commerce Commission, supra,* the Court said (p. 196):

> We think this a proper occasion to express disapproval of such a method of procedure on the part of the railroad companies as should lead them to withhold the larger part of their evidence from the Commission and first adduce it in the Circuit Court. * * * The theory of the Act evidently is, as shown by the provision that the findings of the Com-

> mission shall be regarded as prima facie evidence, that the facts of the case are to be disclosed before the Commission.

The foregoing was quoted with approval by this Court in its opinion in *Oregon R. R. & N. Co.* v. *Fairchild*, 224 U. S. 510, 523, *et seq.*

A leading authority upon the proposition that a statute can not be upheld if it withholds from the courts the power to determine the question of confiscation according to their own independent judgment is the *Ohio Valley Water Co.* v. *Ben Avon Borough et al.*, 253 U. S. 287, 289. The principle there stated is that—

> The order here involved prescribed a complete schedule of maximum future rates and was legislative in character * * * In all such cases, if the owner claims confiscation of his property will result, the State must provide a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause, Fourteenth Amendment.

But even in that case there is nothing in the opinion of the Court indicating that "an adequate judicial hearing as to confiscation" required or authorized the court to hear the case *de novo*, and to receive testimony in addition to that submitted to the state commission. What the Court decided constituted a denial of due process of law was that

the state statute, as construed by the Supreme Court of Pennsylvania, so limited the jurisdiction of the court in injunction proceedings to set aside, annul, or modify an order of the state commission, that it "stopped short of what must be plainly entrusted to some court." The question of the right to a trial *de novo* or to submit evidence not before the commission was not considered or passed upon by this Court in the opinion in that case. It is self-evident that there can be, in the Court's opinion, "an adequate judicial hearing as to confiscation" if the courts are not precluded by statute from determining the question of confiscation upon their own independent judgment as to both law and facts; and that such a hearing is accorded when consideration is given only to the evidence before the Commission, without the receipt of additional evidence in court.

That case does not support, in any way, the contention of the appellants that they were entitled to a trial *de novo* and to submit new evidence in court in the present proceeding. There the review held by the Court to be insufficient was provided by a law of Pennsylvania; here the proceeding has been brought under an act of Congress, Section 207 of the Judicial Code. In that case an order by the Public Service Commission was involved; here an order of the Interstate Commerce Commission is attacked by the appellants. In the Court's opinion in that case all that was insisted upon was that in

confiscation cases "a fair opportunity for submitting that issue to a judicial tribunal" must be provided; here there is no question and there can be no question that, if confiscation is an issue in this case, a fair opportunity exists for submitting that issue to the courts (*Dayton-Goose Creek Ry. Co.* v. *U. S.*, *supra*), as well upon the record made by the Commission as it could be presented upon a record in court.

In stating the grounds for its ruling in sustaining objections to the offer of testimony *de novo* the statutory court, after referring to the contention of the petitioners that they had a right to present the case *de novo* in court, said (R. 180, 181):

> We think this should not be done because such a course would effectually nullify the power of the Commission as a fact-finding body and substitute the courts in its place. We think the function of the courts as to such actions of the Commission is limited to reviewing the action of the Commission with a view of testing whether it has failed to act in accordance with the law governing its action and whether it has arbitrarily reached the conclusion at which it arrived. Obviously, a *review* of the action of the Commission must be upon the record before the Commission and none other because it was upon such record alone that the Commission should and is presumed to have acted. We think this view is required by numerous holdings of the Supreme Court of which the most recently

reported is *Western Chemical Co.* v. *United States,* 271 U. S. 268, 271. Therefore, this court should not try this matter *de novo* but all evidence not before the Commission should be excluded.

This ruling of the statutory court was clearly correct.

## CONCLUSION

The method adopted by the Commission in the *O'Fallon case* gives all the consideration to current reproduction cost which the Commission regards as "due" or practicable if the Transportation Act is to be made administratively effective. The method is intelligible. It is workable. It is "fair." It furnishes a "rule of reason" applicable to railroad regulation. It does not confiscate property or property rights. The annual return which the O'Fallon will receive for three recapture periods on the "value" of its property as fixed by the Commission will be in excess of 12% on that value, and would be much more than 6% on "reproduction cost" under any theory supported by the record.

The Commission has dealt with realties. The existing national railroad rate structure is substantially consistent with the method of determining "value" adopted in the O'Fallon case. Railroad credit has never been better than it is to-day. Railroad stocks and bonds have never been more highly regarded for investment. If, as is believed, we are facing a period of deflation and of general price

decline the adoption of the theory of reproduction cost would shake railroad credit and make difficult the issuance of new securities, whether stocks or bonds. To substitute for the principles and administrative methods which have produced the present favorable conditions, principles and administrative methods under which rates will be confiscatory if they are not greatly increased and under which railroad stocks will become the most speculative securities on the exchanges, would be, in the judgment of the Commission, to destroy any effective regulation of railroad rates and to discredit and perhaps destroy the whole system of private ownership and operation.

Respectfully submitted.

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